FENWICK & WEST LLP

# Entering the U.S. Market

## for High Technology Companies

FENWICK & WEST LLP

## About the Firm

Fenwick & West LLP provides comprehensive legal services to high technology and biotechnology clients of national and international prominence. We have over 250 attorneys and a network of correspondent firms in major cities throughout the world. We have offices in Mountain View and San Francisco, California.

Fenwick & West LLP is committed to providing excellent, cost-effective and practical legal services and solutions that focus on global high technology industries and issues. We believe that technology will continue to drive our national and global economies, and look forward to partnering with our clients to create the products and services that will help build great companies. We differentiate ourselves by having greater depth in our understanding of our clients' technologies, industry environment and business needs than is typically expected of lawyers.

Fenwick & West is a full service law firm with nationally ranked practice groups covering:

- Corporate (emerging growth, financings, securities, mergers & acquisitions)
- Intellectual Property (patent, copyright, licensing, trademark)
- Litigation (commercial, IP litigation and alternative dispute-resolution)
- Tax (domestic, international tax planning and litigation)

**Corporate Group**

For 30 years, Fenwick & West's corporate practice has represented entrepreneurs, high technology companies and the venture capital and investment banking firms that finance them. We have represented hundreds of growth-oriented high technology companies from inception and throughout a full range of complex corporate transactions and exit strategies. Our business, technical and related expertise spans numerous technology sectors, including software, Internet, networking, hardware, semiconductor, communications, nanotechnology and biotechnology.

## Our Offices


| | |
|---|---|
| Silicon Valley Center | Embarcadero Center West |
| 801 California Street | 275 Battery Street |
| Mountain View, CA 94041 | San Francisco, CA 94111 |
| Tel: 650.988.8500 | Tel: 415.875.2300 |
| Fax: 650.938.5200 | Fax: 415.281.1350 |


For more information about Fenwick & West LLP, please visit our Web site at: www.fenwick.com.

## Entering the U.S. Market for High Technology Companies

### Table of Contents

## Introduction

Penetrating the U.S. market is an important part of a foreign high technology company's business strategy. The U.S. market is large, homogeneous, and a traditional leader in technology products. The rewards of a successful U.S. presence can be extremely gratifying. In addition to the U.S. market opportunity, establishing and maintaining market share in the U.S. can play an important role in maintaining technical advantage and market share in your home market. How should you enter the U.S. market? What rules do you need to be aware of in order to do business in the U.S.?

This booklet is intended to provide technology companies located outside of the U.S. with an overview of key legal issues involved in entering the U.S. market. The first section of this booklet addresses product distribution issues. The second section focuses on setting up a permanent business presence in the U.S. The booklet emphasizes California laws, but the legal issues are similar in other states. This booklet is only an overview and is no substitute for professional analysis and advice. We would like to assist you in dealing with the difficult problems encountered in entering the U.S. market. For additional assistance, please contact Fred M. Greguras in our Mountain View office at 650.988.8500

## Distributing Your Product in the U.S.

### Choosing Your Distribution Channel

The U.S. offers foreign companies a large, easy-to-access marketplace, if you select the right distribution channel and follow a few legal rules. Selecting the right distribution channel and U.S. partner for your product and market is important. To be successful, your U.S. partner must have the technical and financial capability to support your product and the right distribution channel to reach your target customers.

You can enter the U.S market by means of internet access, sales representatives, distributors, licensees, OEMs or VARs or by establishing your own subsidiary. You may also combine several of these approaches since they are not mutually exclusive. For example, a license agreement may allow the licensee to purchase final product from you for resale (distribution), localize your product for the U.S. market, manufacture and distribute the localized version of the product (license) and finally create a joint venture subsidiary to jointly develop and market new products (license and direct sales). This section describes the characteristics, and evaluates the advantages and disadvantages, of each of these distribution methods. If you have questions regarding these issues, contact Fenwick & West's Intellectual Property Transactions Group. It has extensive experience in helping companies negotiate these types of arrangements.

#### Sales Representatives

***Characteristics.*** A sales representative solicits orders from U.S. customers that your company may accept or reject, is paid a commission (a percentage of the representative's sales), generally stocks no inventory, takes no title to goods, and cannot bind your company to make the sale. Representation rights are usually limited to a specified geographic territory and can be either exclusive or nonexclusive.

***Advantages.*** Your out-of-pocket costs of entering the U.S. market will be low. Since your company contracts directly with the end-user, you control product pricing and customer relationships. If you maintain no physical presence in the U.S. and the representative cannot contractually bind you, you generally will avoid U.S. income tax. Selling through a sales representative will net you a higher percentage of retail revenues than selling through distributors or licensees.

***Disadvantages.*** Using a sales representative may not be effective for mass-marketed computer software or for sophisticated technology products. Sophisticated products often require significant presale demonstration and customer education or post sale technical support. These services are not generally available from a sales representative. Sales representatives who handle multiple product lines also may not provide the focused attention needed for a new product introduction. Lastly, you bear the credit risk for end-user sales obtained by the sales representative.

### Distributors

***Characteristics.*** A distributor buys products at a discount and resells or "licenses" them at a profit to dealers within a specified territory. The size of the distributor's discount is partially based on the scope of the distributor's functions. Distributors typically have sales offices and trained personnel, keep inventory, and handle both presale demonstrations and post-sale service and support. If you ask the distributor to spend substantial amounts marketing your products, it is likely to want an exclusive territory and a contract term long enough to amortize its initial investment in your product. Because distributors sell products for their own account, U.S. law requires that you let them set their own prices.

***Advantages.*** Your out-of-pocket costs for entering the U.S. market through distributors will be low. Since a distributor sells products for its own account, the distributor bears the inventory risk and credit risk for its sales. The distributor's permanent presence generally permits it to do a more effective job of marketing high technology products than a sales representative. You will not have a permanent establishment for tax purposes and, therefore, will not have U.S. tax liability if your only U.S. presence is through a distribution arrangement. Distribution arrangements seem to work best for hardware, specialized components and massmarketed software distributed through retail outlets.

***Disadvantages.*** A distributor may lack the technical skills needed to localize or effectively support your product. Distributors frequently market a range of related products, which may deny your product the focus needed for a successful product introduction. The distributor, not you, will build the business relationships and goodwill with your customers. Since distributors generally purchase product at a substantial discount off of list price, you will get a smaller percentage of each retail sales dollar than if you market your products through a sales representative.

Some technology products do not fit neatly into the traditional buy-sell distribution arrangement. Computer software is a good example. Computer software is protected by copyright law. Under copyright law, only the author of the software or its licensee is entitled to reproduce, modify or distribute the software. Software companies therefore license their software instead of selling it. Even mass distributed software is generally "sold" under a "shrink-wrap" or "click-wrap" license that attempts to retain the company's ownership of the software. Unsigned licenses, like the shrink-wrap software license, may not always be enforceable. Click-wrap licenses are more likely to be enforceable, as long as the user is required to scroll through the license before being allowed to click on the "I accept" button. Enforceability is more suspect if the license terms are accessible by hyperlink, but need not be viewed prior to acceptance. Distribution arrangements for mass distributed software closely resemble traditional distribution agreements despite these shrink-wrap licenses.

Software distribution agreements require some special considerations however. The appropriate scope of the license, use restrictions, means of enforcing compliance with restrictions and ways to minimize sales tax are dependent on the specifics of your business and objectives. The more sophisticated the software, the more important is careful selection of a distributor with requisite technical expertise.

There are other drawbacks to marketing high technology products by means of the traditional distributor arrangement in the international context. Price competition may make distribution less attractive. For example, the typical "price" to a distributor of software will be higher than the typical royalty paid by a licensee for the right to reproduce and package the software. In a highly competitive market, to be competitive with third party products you may need to license technology rather than sell product through distribution.

**OEMs/VARs**

***Characteristics.*** A license agreement is necessary whenever you want to have your business partner modify, manufacture or reproduce patented or copyrighted technology or make use of confidential know-how or trademarks, in addition to distributing a computer product. An original equipment manufacturer (OEM) or value added remarketer (VAR) is like a distributor except the OEM/VAR must add value of some type (hardware or software) when it resells or licenses your product. These arrangements can become quite complex when the OEM/VAR must technically integrate their product into yours. They may require access to your APIs or a source code license to accomplish such integration, as well as greater restrictions and controls on use of such materials. OEMs generally market the product under the OEM's name while VARs generally market the product under your name. When you grant rights to modify, manufacture or duplicate your product, you receive a royalty from the licensee for the rights granted rather than the purchase price for the product sold.

***Advantages.*** Licensing arrangements can give you greater flexibility in tailoring your product to the needs of your customers. Licensees tend to have the technical skills and local market familiarity needed to do a good job of localizing your product. Customs duties can be reduced and freight eliminated by licensing technology rather than shipping final product. Licensees who manufacture the product will bear manufacturing, as well as inventory costs. Licensees are likely to be more familiar with your product's technology, are in the customer's time zone and speak the local language, all of which better equip them to support highly technical products once sold. You should not have a permanent establishment for tax purposes.

***Disadvantages.*** Licensees have greater access to how your technology works than do distributors or representatives. Your licensee will gain first hand understanding of the market and customer needs, as well as a technical understanding of the strengths and weaknesses of your technology. If your relationship fails, that market understanding could make it a formidable competitor. The opportunities for piracy grow as more companies manufacture your product subject only to contractual restrictions. Because of the additional functions performed by the licensee, license royalties will net you an even smaller percentage of each retail sales dollar than if you market your products through a distributor. Also, while the U.S. will not tax product sales revenue paid to you, royalties paid to you by a U.S. licensee may be subject to up to a 30% U.S. withholding tax, depending on whether your country has entered into an income taxation treaty with the U.S.

**Direct U.S. Presence: Subsidiary or Branch Office?**

At the far end of the continuum of increasing involvement is establishing a local presence to address the U.S. market. While this can be either a subsidiary or a branch office, a subsidiary has three advantages over a branch office. First, assuming you follow proper formalities, its separate legal existence limits your liability to your investment. Second, there are tax advantages. Branches or local employees authorized to accept orders are treated as creating a permanent establishment for you in the U.S., subjecting you to U.S. income tax on your operations. Since the subsidiary is a separate taxpayer, the parent company has no permanent establishment and its liability for local income taxes is thus limited. Finally, it demonstrates a greater commitment to the U.S. market. As an initial matter, many companies first set up a subsidiary to handle manufacturing and/or customer support and continue to use the distribution channels described above. As they gain more experience in the market, they may start doing their own localizations and marketing as well. If the product justifies it, they may recruit a local sales force to sell direct to U.S. customers.

A branch office puts the assets of the foreign company at risk, but is generally simpler and cheaper to establish and operate than a subsidiary corporation. The branch office must qualify to do business with the state where it is located by a “mini” incorporation process.

U.S. tax law is important in deciding between a branch and a subsidiary. The federal “branch profits tax” enacted as part of the Tax Reform Act of 1986 reduces the desirability of branch operations unless a tax treaty provides otherwise. Under the “branch profits tax,” branch office remittances are taxed like dividends paid by a subsidiary. This is in addition to the tax on the income attributable to your branch office. Complex rules govern the “branch profits tax” and the allocation of expenses deductible from such income. Another important factor in favor of a subsidiary is that U.S. Internal Revenue Service (IRS) tax audits are limited primarily to the subsidiary and not the parent, except for Section 482 issues (transfer pricing adjustments for related-party transactions). With a branch office operation, the foreign parent may be subject to a more extensive IRS audit. Use of a branch may also subject you to direct state and local taxation. For all of these reasons, most companies prefer to set up a U.S. subsidiary rather than a branch office.

U.S. customers recognize that setting up a U.S. subsidiary is a commitment to the U.S. market. The cost of this commitment can be substantial, including the costs of hiring people, renting an office and setting up operations, learning how to operate in the U.S., establishing distribution channels, reaching customers, and learning their needs and preferences. The second half of this booklet will discuss some of the issues involved in setting up your U.S. subsidiary.

**Protecting Your Intellectual Property**

High technology products are costly to develop and frequently can be reverse-engineered, manufactured and distributed by competitors at a fraction of your original development cost. The U.S. has been a leader in enacting laws to protect the intellectual property embodied in such technology.

The U.S. is also a member of the major intellectual property conventions: the Berne Convention, the Universal Copyright Convention (UCC), the Paris Convention, and the Buenos Aires Convention. These treaties give nationals of other member countries the same intellectual property rights in the U.S. as U.S. nationals and provide certain timing priorities for patent and trademark applications.

Most industrial countries have laws protecting copyrights, patents and trademarks. This section describes these forms of protection and the procedures required to obtain protection in the U.S. For patent protection in the U.S., you must file a patent application. You can obtain trademark, copyright and trade secret protection without registration. The U.S. Semiconductor Chip Protection Act provides reciprocal protection for chips developed in mask work treaty countries. Even without treaty protection, your mask work is eligible for protection if it is first commercially exploited in the U.S. Fenwick & West's Intellectual Property Group can help you establish costeffective means of protecting your intellectual property.

***Copyright.*** Under U.S. copyright law, an author has the exclusive right to copy and distribute his work and prepare derivative works. Computer software, user documentation and marketing literature are protected by U.S. copyright law. Copyright protection is particularly important for massmarketed software because of the practical difficulty of obtaining signed end-user license agreements.

The UCC, Berne and Buenos Aires Conventions provide that works of an author from any of the member countries that are brought into the U.S. automatically enjoy the same copyright protection as would the work of a U.S. author. Software developed in any UCC, Berne or Buenos Aires country and imported into the U.S. will therefore be protected by U.S. copyright.

In the U.S., a work is protected by copyright if the expression is original to the author, regardless of whether the concepts expressed are novel and unobvious. The law does not impose a higher standard of originality on software than for other works. U.S. copyright protection is available for the life of the author plus 70 years (or 95 years after publication or 120 years after creation, whichever expires first, for a corporate author).

Under the UCC, the only required formality for protection is that the author place a copyright notice on the work, consisting of his name, the word "copyright" or the symbol ©, and the year of first publication. Since March 1989, when the U.S. joined Berne, U.S. law no longer requires a copyright notice, but use of a notice is still highly recommended. A notice informs the world of your exclusive rights in the work and provides certain evidentiary advantages in infringement actions. To obtain protection under the Buenos Aires Convention, you should add the words "All Rights Reserved" to your copyright notice. This treaty is less important since most member states have also adopted the UCC, which supersedes the Buenos Aires Convention to the extent they conflict.

Copyright protection in the U.S. is both narrower and broader than in other countries. While the Berne Convention and the copyright laws of most other countries protect an author's "moral rights," such rights are less developed under U.S. copyright law. A U.S. author of a work (other than a work of visual art) who assigns his copyright to a third party retains no right to have his name associated with the work or to prohibit modifications of the work that would injure his reputation. Both foreign and U.S. copyright law purport to protect only the "expression of ideas, and not the ideas themselves." U.S. case law, however, has in certain situations, broadened protection to cover the "look and feel" of computer programs, with some courts even protecting the "structure, sequence and organization" of software even where no actual copying of the program code occurs.

***Patents.*** A U.S. patent gives an inventor the right to exclude others from making, using, selling or importing the patented product or process in the U.S. Patents may be issued for any "novel, unobvious, and useful process, machine, or composition of matter or improvement thereof." Unlike copyright, a patent protects the idea embodied in an invention. Unlike trade secrets and copyright, independent creation is no defense to a patent infringement claim. Electronic products, manufacturing processes and computer software often are protected by patents.

Patentees should affix the word "patent" or the abbreviation "Pat." on patented articles, together with the patent number. Without proper patent notices, the patent holder must prove that an alleged infringer had actual notice and can receive damages only for infringement after notice. Those who willfully infringe a patent can be liable for up to three times actual damages. Patent protection lasts for up to 20 years from filing of the U.S. patent application.

A foreign patent is not automatically protected by treaty in the U.S. To obtain U.S. patent protection, you must file a patent application with the U.S. Patent and Trademark Office (PTO). However, foreign nationals do receive some benefits by treaty. Under the Paris Convention, member state nationals receive the same treatment as U.S. nationals under U.S. patent law. In addition, patent applications filed in the U.S. within one year of a filing in a member state are treated as if they had been filed in the U.S. on the foreign filing date.

Unlike the rest of the world, the U.S. currently grants patents to the "first to invent," rather than the "first to file." Thus, it is possible for a foreign company that is first to file a U.S. patent application to lose patent priority to someone who files a U.S. patent application later for the same invention, but who can prove that he reduced the invention to practice in the U.S. before the first filer did.

You also can lose the right to obtain a U.S. patent if you fail to file your U.S. patent application within one year of: (i) the publication of your patent application in a Paris Convention country or elsewhere; (ii) the first time you offer the product for sale or show it at a U.S. trade show; or (iii) your first sale or use of the product in the U.S. These actions destroy the "novelty" of the invention, making it no longer patentable in the U.S.

***Trademarks.*** Trademark protection is often essential to develop a market, particularly for mass-marketed products. A trademark identifies your goods and services and symbolizes your quality standards and reputation.

Unlike most of the rest of the world, you can obtain U.S. trademark protection simply by adopting a mark and using it on goods or in connection with services sold in the U.S. The first to use a mark in the U.S. has the exclusive right to the mark in the territory where it was used. With certain exceptions, a senior user can prevent a junior user from using the same or a similar mark if such use is likely to cause confusion in the mind of the relevant public. Trademarks not registered with the PTO should be indicated by a TM, to show that you are claiming the word as your trademark.

Although you obtain common law trademark rights by use, we recommend that you register any mark that you intend to use or have in fact adopted and used in the U.S. Trademark registration provides significant benefits, including nationwide protection regardless of the area of actual use. PTOregistered trademarks should be indicated by an ®. Once registered, you should continuously use your mark since a three-year span of non-use may be considered abandonment of the mark. You should also file affidavits of use with the PTO between the fifth and sixth years after registration to establish incontestability and continued use, making your mark eligible for renewal after ten years of registration.

Under the Paris Convention, member state nationals seeking trademark protection in the U.S. receive the same treatment as U.S. nationals. The convention also provides that U.S. trademark filings, made within six months of a member state filing, will be treated as if filed on the date of the original filing in the Paris Convention country.

Before shipping product to the U.S., you should have a trademark search done to make sure that your desired mark is available for use in the U.S. To better protect that trademark, you should file a U.S. trademark application. Your agreements with U.S. sales representatives, distributors and licensees should prohibit them from registering your trademarks.

***Trade Secrets.*** A trade secret is defined by most states as any information that derives value from not being generally known and is the subject of reasonable efforts under the circumstances to protect its secrecy. Unlike most other types of proprietary protection available in the U.S., trade secrets are not limited in duration and can potentially last forever.

Manufacturing processes, technical information and computer software source code often are protected as trade secrets. Trade secret protection requires that you take reasonable steps to protect your secret. For example, you should limit access to the secret and obtain signed nondisclosure agreements from those to whom you give access to the secret. Unless someone agrees not to reverse-engineer your product, they are free to use information disclosed by examination of that product. Distributing object code versions of software, without obtaining a signed license, is insufficient to maintain trade secret protection for your software.

**Getting Your Product Through U.S. Customs**

Before shipping product into the U.S., find out how your product will be classified and valued by U.S. Customs and what procedures you must follow. This section briefly outlines the most significant of these issues. Fenwick & West's Washington D.C. office can assist you with Customs issues.

***Product Entry.*** All products entering the U.S. must comply with U.S. Customs import or "entry" formalities. Licensed customs "brokers" can help clear your products through Customs by preparing required entry forms (which describe the imported items, their "value" for Customs purposes and the Harmonized Tariff Schedules of the U.S. (HTSUS) and their "classification" number), and complying with Customs procedures, such as the deposit of estimated Customs duties and user fees, bills of lading, and bonds.

Your U.S. customs duty will equal the value of the goods imported multiplied by the tariff rate specified by the classification number for such goods. Although U.S. tariff rates generally are very low, you can avoid unpleasant surprises by determining the proper classification and valuation method before your products arrive at a U.S. port.

The HTSUS is based on the Brussels-based Customs Cooperation Council's international tariff classification system, used by most countries around the world. It is extensively indexed to make it easier to identify the proper classification number. Nonetheless, HTSUS product descriptions do not always correspond to commercial descriptions.

You are required to correctly classify products entering the U.S. When in doubt (and to avoid a potentially costly Customs dispute), you can request a prior Customs ruling on your product's classification. Such a ruling can eliminate future disputes with Customs regarding your product classification. Before or in lieu of seeking a ruling, you may want to review published Customs rulings on other classification requests. While these provide helpful guidance, such rulings are binding only for the party requesting the ruling and may not be relied on by others.

In order to determine the Customs duty owed, you will need to "value" the imported product using one of the following five methods:

- Transaction value of the imported merchandise
- Transaction value of identical merchandise
- Transaction value of similar merchandise
- Deductive value
- Computed value

Customs valuation regulations require that you use these valuation methods *in the order listed above*. For example, you can only use "transaction value of similar merchandise" if you cannot qualify for use of "transaction value of the imported merchandise" or "transaction value of identical merchandise." Most importers can use the "transaction value of the imported merchandise." "Transaction value" refers to "price actually paid or payable" (adjusted as required by Customs regulations).

Customs frequently questions the "transaction value" of product sold by a foreign parent to its U.S. subsidiary. You should be prepared to show that your relationship did not influence price (*i.e.*, that you used an "arm'slength" price). The declared value for entry purposes should be the same as the transfer price reported to the U.S. IRS.
If importing software into the U.S., note that Customs assesses duty only on the value of the magnetic media. No duty is due on the value of the intangible, but often very valuable software.

***Drawback.*** If you import goods into the U.S. to manufacture finished goods that you subsequently export from the U.S., you may be eligible for a refund of duties paid under Customs “drawback” regulations. The “drawback” regulations are very technical, but can result in substantial savings.

***Tariff Preferences.*** Imports from some countries may be eligible for dutyfree entry into the U.S. under various preferential tariff programs such as the Generalized System of Preferences (GSP). GSP authorizes duty-free entry of certain products identified in the HTSUS from developing countries identified in the HTSUS. Other preferential tariff programs include the North American Free Trade Agreement (NAFTA), the U.S.-Israel Free Trade Agreement and the Caribbean Basin Initiative. Under these programs, many tariffs are either reduced or eliminated.

***Non-Tariff Considerations.*** The U.S. often imposes quotas and tariff sanctions on specific products (and specific countries) as a result of international trade disputes. The U.S. also may prohibit importation of products from certain embargoed countries for foreign policy reasons. You may need to obtain product safety approvals from other U.S. agencies for specific types of product. For example, the Food and Drug Administration approves pharmaceuticals and related products as well as certain radiological devices, including computer monitors, while the Federal Communications Commission must approve many computer devices for importation and sale in the U.S.

***Product Marking.*** U.S. law requires that you mark imported products with your country of origin. When an imported product contains parts from many different countries, the country of origin marking must reflect where the product underwent “substantial transformation” (generally, the country where it was assembled). Like HTSUS classifications, “substantial transformation” determinations are subject to Customs rulings, which can provide guidance for marking purposes.

The Federal Trade Commission (FTC) also regulates the marking of products sold in the U.S. Under current FTC policy, you may not mark a product “Made in the USA” if the product contains any foreign parts or components. Use of “Made in the USA” markings on such products is deemed a deceptive trade practice. For FTC purposes, U.S.-assembled products that contain imported parts should be marked “Assembled in the USA from U.S. and imported parts” (or similar wording). Like Customs, the FTC has issued advisory rulings that provide guidance on current FTC product-marking policy.

### Commercial Law Requirements

***Contracts for the International Sale of Goods.*** If your country is a member of the Convention on Contracts for the International Sale of Goods (CISG), you should consider the application of CISG to your distribution agreement or any purchase contract with a U.S. party. CISG is an international treaty that automatically applies whenever a contract for the sale of goods is entered into between parties who are located in countries that have ratified CISG unless the parties "opt" out of CISG in their contract. It probably applies to distribution license agreements of mass-marketed computer software, although it would not apply to agreements where the predominant performance is service.

While CISG generally resembles the Uniform Commercial Code (UCC) discussed below, there are some significant differences from U.S. law. For example, CISG has no statute of frauds, so an oral offer and acceptance will be binding even if there is no written contract confirming the agreement. Similarly, an offer under CISG may be irrevocable if it is reasonable for the person receiving the offer to assume it is irrevocable. If you decide you do not want your agreement to be governed by CISG, the contract's choice of law provision should read as follows: *"This Agreement will be governed by the laws of the State of California, excluding the Convention on Contracts for the International Sale of Goods and that body of law known as conflicts of law."*

***Uniform Commercial Code.*** The UCC is the law that will govern the sale of products from your U.S. subsidiary to distributors or customers in the U.S. except in Louisiana. Some states and federal law provide additional protections in consumer (as opposed to commercial) transactions. Some courts have treated the license of software as a "sale of goods" subject to the UCC. Although it is not clear that software licenses will be subject to the UCC in all jurisdictions, most software licenses address UCC issues.

***General Contract Terms.*** U.S. agreements are typically more detailed than European or Asian agreements because U.S. courts look to the agreement to determine the parties' intent. To have a binding agreement under the UCC, the parties must specify the price, quantity and type of goods to be sold. Contracts for over $500 of goods must be written. In addition to these required terms, your agreements should specify the distributor's obligations, intellectual property provisions (*e.g.*, prohibitions on reverse-engineering, any use restrictions and confidentiality obligations), delivery, allocation of taxes, passage of title and risk allocation (*e.g.*, F.O.B., Ex Works). The parties may specify the jurisdiction whose law will govern the agreement, the means of dispute resolution (*i.e.*, litigation or arbitration), and the location of dispute resolution (*e.g.*, the state and federal courts of a certain state or district). In some circumstances, agreement terms will be implied by the parties' course of dealing or by common trade practices.

***Warranties.*** There are two types of product warranties that companies give to their customers: implied warranties and express warranties. Implied warranties are provided by statute if the agreement does not expressly disclaim them. Warranties of "merchantability" (products must be of average quality and pass without objection in the trade) and "noninfringement" (products will not infringe a third party's intellectual property rights) are always implied if not expressly excluded or modified. If the seller knows of the buyer's particular purpose and knows that the buyer is relying on the seller's judgment to select suitable goods, the warranty of "fitness for a particular purpose" (products must be suitable for the purposes for which they are sold) is also implied unless expressly excluded or modified. U.S. sellers typically disclaim warranties of merchantability and fitness for a particular purpose. To be enforceable, your disclaimer must be in writing and conspicuous (*i.e.*, in capital letters and/or boldface type). Consumer protection laws limit disclaimers of implied warranties for consumer products.

Express warranties are written promises by the seller as to the quality of material or workmanship or expected performance of the products sold. Agreements for the sale or license of high technology products, including software, usually include a limited warranty stating that the product will be free from defects in materials and workmanship, and will conform to the product's written specifications or perform in accordance with the user's manual. Warranties are typically limited in duration (*e.g.*, 30 days to a year after purchase) and specify the sole remedies available in the event of a product defect (*e.g.*, repair, replacement, or refund of the purchase price). Some sellers sell or license products "As Is," with no warranty at all.

***Limitations of Liability.*** Given the greater likelihood of litigation in the U.S., U.S. sellers often attempt to limit their liability for damages to a maximum dollar amount or to the cost of the products sold. Sellers also attempt to limit their liability for "consequential" and "incidental" damages. Whether these types of limitations will be enforceable depends on the circumstances of the transaction. Consumer protection laws also require certain qualifications in consumer transactions.

**Antitrust Constraints**

The U.S. has a complex body of antitrust laws that can affect your commercial agreements and business practices. These laws are enforced primarily by federal and state governments, but, at times, by private parties. Violations can result in both civil and criminal penalties as well as damage awards that are automatically trebled. Also, U.S. and foreign authorities cooperate by sharing evidence and prosecuting international antitrust cases. This section highlights the restrictions that are most likely to affect your U.S. business practices. You can address your questions regarding antitrust issues to Fenwick & West's attorneys in this area.

***Vertical Restraints.*** A vertical restraint is an agreement between a supplier and its distributor or licensee that limits either party's ability to freely sell, license, resell, or sublicense products. U.S. law distinguishes between restraints that directly affect price and those that do not. Resale price maintenance (*e.g.*, an agreement by your distributor or licensee on the price at or above which it will resell your products) violates U.S.

antitrust law. You may "suggest" resale prices to your distributors or licensees if they remain free to deviate from such prices.

Nonprice vertical restraints include exclusive distributorships, exclusive dealing provisions (agreements not to carry competing products), territorial limitations (including absolute bans on sales outside a territory), customer and field of use restrictions, and technology grant-backs. Unlike European Union antitrust law, these provisions generally are permissible in the U.S. They are illegal only if they unreasonably restrain trade. Courts will balance the anticipated anticompetitive and procompetitive effects of the restraint, taking into account market shares of the parties, scope and duration of the restriction, justification and other factors.

***Tying Arrangements.*** Tying arrangements require the purchase of a "tied" product or service as a condition of receiving a second "tying" product or service. Tying violates U.S. antitrust law if: (1) there exists a demand for one product or service separate from the other; (2) the tying product has sufficient market share, uniqueness, patent or copyright protection to force the purchase of the tied product; (3) the products are in fact tied together (not reasonably obtainable separately); (4) some degree of commerce in the market for the tied product is foreclosed as a result of the tie; and (5) the supplier is unable to show a legitimate, procompetitive business justification that requires the imposition of the tie.

***Discrimination in Prices and Services.*** The Robinson-Patman Act prohibits certain discrimination in price or in promotional services or allowances among resellers where such discrimination injures competition. This prohibition on price discrimination applies whether or not the supplier has a dominant position. As with violations involving vertical restraints and tying, violators are liable for three times actual damages sustained.

Under the Robinson-Patman Act, it is illegal to sell products of like grade and quality at different prices (taking into account all product, shipping and handling charges, as well as rebates and discounts) to different buyers for use, consumption or resale in the U.S. where such buyers (or their customers) compete with one another. You can offer different prices if the better price is available to all purchasers, the sales are not reasonably contemporaneous, or if you give the better price to a particular customer in a good faith effort to meet a competitor's price.

You must also make promotional allowances and services available on equivalent terms to all competing resellers. This requirement includes cooperative advertising, promotional literature, sales and marketing assistance, and other payments and services in connection with resales.

***Refusal to Deal and Termination of Resellers.*** U.S. suppliers generally are free to decide to whom they will or will not sell. This right is limited in two circumstances. First, it is often illegal not to sell if the decision is made in concert with others, particularly as part of a boycott among suppliers or competing resellers. Second, if the supplier has monopoly power in the products being withheld or the product is essential for the customer to compete, then the supplier may have an obligation to deal, depending on the effects of and justifications for its refusal.

A supplier is usually most at risk when it terminates an existing distributor or dealer. A terminated reseller often claims such termination was part of an effort to enforce an otherwise unlawful agreement regarding price-fixing or other types of vertical restraints. In addition, certain states limit the ability of a supplier to terminate a reseller (*e.g.*, requiring good cause, minimum duration of the relationship, or a minimum notice period prior to termination). Generally, however, it will be easier and less expensive for you to terminate distributors and dealers in the U.S. than in Europe or Latin America.

Additional restrictions apply if the relationship between a seller and reseller is found to create a franchise under franchise laws. A franchise may exist under these laws in spite of the intent of the parties. To reduce the risk that your distributor or license agreements will be treated as a franchise, you should avoid extensive restrictions on the way the reseller does business, the use of your trademarks and the payment of fees other than for products. If a high degree of control over resale practices is necessary, you may want to establish a wholly owned subsidiary to handle U.S. sales.

***Restraints on Licensing of Intellectual Property.*** U.S. law protects the intellectual property owner's right to control the use and disposition of such property. Thus, the holder of a U.S. patent can limit the fields of use and/or territories in which a licensee may practice a patented invention and may require that the licensee purchase goods that are a material part of the invention and have no substantial noninfringing uses. Similarly, a copyright holder generally can restrict the scope of a licensee's use or distribution of copyrighted material. However, certain restrictions imposed by a licensor may constitute "misuse."

Misuse is an attempt by a patent or copyright holder to extend his rights beyond their inherent scope that causes harmful effects in the market for a product or service not covered by the patent or copyright. Misuse may exist where a license grant is tied to the purchase of other products, services or licenses that the licensee is required not to develop or when the licensee agrees not to deal in competing goods, or if the licensee is charged royalties beyond the life of a patent.

A licensor that misuses its patent or copyright cannot enforce its rights against infringers (whether or not the infringer has been affected by the misuse) until the misuse is ended and its harmful effects abated. Given the importance of intellectual property rights, the threat of a misuse finding is often a greater risk than antitrust damages.

The federal antitrust authorities regularly investigate potentially anticompetitive licensing practices. Areas of greatest concern involve practices that may reduce the amount and scope of overall research and development, or innovation, in a particular market. Recent investigations have included a variety of industries and both U.S. and foreign parties.

## Establishing a U.S. Subsidiary

### Locating Your Business

Deciding where to locate your business involves a number of marketing, legal and financial factors, including state property and income tax rates, incentives available for the specific type of business and the skill level needed for your work force. The decision to locate in California, for example, may be driven primarily by the need to be near customers or in the center of a service territory. A common reason for deciding to locate in California is the concentration of high technology companies in Silicon Valley and elsewhere in the state.

U.S. subsidiaries initially tend to be sales and marketing or research and development operations rather than assembly or manufacturing operations. Incentives that are applicable to manufacturing operations (such as reduced property taxes) are not relevant to a sales and marketing operation, which will not need a substantial physical facility or equipment.

The state unitary tax issue discussed below under "State Taxation" is also important in selecting the location for a subsidiary. If a company operates in California, however, it cannot avoid California taxes.

### Creating a U.S. Subsidiary

Forming a corporation is simple. You create a California corporation by filing articles of incorporation with the Secretary of State and paying a modest annual franchise tax. Thereafter, it maintains its status by complying with statutory formalities. The California corporation becomes a subsidiary when the foreign company buys a majority or all of its shares.

A California corporation may have only one shareholder (i.e., the foreign company). The shareholders own the corporation and elect a Board of Directors. If the corporation has only a single shareholder, it may have just one director. (When there are two shareholders, there must be two directors. When there are three or more shareholders, there must be at least three directors.) The Board of Directors governs the corporation and appoints the officers who manage its day-to-day business. There are three required officers: (1) a president (2) a chief financial officer and (3) a secretary. The same person may fill all three roles. Neither the directors nor officers need be U.S. residents, although someone should be present on site with authority to act on behalf of the corporation.

If you follow statutory formalities, then your liability should be limited to the assets of the U.S. corporation. If you don't properly organize and maintain the corporation, a court can "pierce the corporate veil" and look to your assets to satisfy the subsidiary's obligations. Filing fees, other costs and legal fees through the initial organizational stage for a wholly owned subsidiary usually total about $3,500.

### Capitalizing Your Subsidiary

***Structure.*** The corporation's capital structure should be simple. You would usually authorize only one class of stock, common stock, since the corporation will be financed entirely by its foreign parent. In California, you would usually authorize one million shares of common stock unless you plan on selling stock to employees and/or others. The stock should be designated "no par" to facilitate qualifying to do business in other states.

You can issue a relatively small number of shares to the foreign parent unless shares will also be issued to employees and others. In that case, the foreign parent will want to hold at least a majority of the shares to be issued in order to retain control. California does not tax corporations on the basis of the number of authorized or outstanding shares, but other states impose such taxes.

***Minimum Capital Requirements.*** The California Corporations Code does not require any minimum investment in a new corporation. For the foreign parent to limit its liability to the value of its shares, however, the initial amount of capital must be adequate to accomplish the purpose of the start-up business. For example, a corporation that will serve as a sales representative or purchasers' liaison for the foreign parent needs less capital than a distributor who will stock inventory. Similarly, a distributor requires less capital than a manufacturing operation. Another factor is whether you will need immigration visas for personnel whom you intend to transfer to your U.S. operation. If you are going to apply for an intra-company transfer visa, you should invest enough capital to finance operations for at least one year, the usual initial visa period. (See "Immigration Law" below.)

***Buying the Subsidiary's Shares.*** A corporation must sell its shares for legal consideration (*i.e.*, cash, property, past services or, under certain circumstances, promissory notes). If you transfer technology or other property (but not services) to a corporation in exchange for stock you will not recognize income at the time of the transfer (as a sale of such property) under IRC Section 351 as long as you acquire at least 80% of the shares of the corporation after the transfer. Because of this limitation, Section 351 is generally available at the time of incorporation but not later. Since a party who exchanges past services for stock must recognize income in the amount of the value of the stock in the tax year in which the stock is received, it is preferable to issue the shares at a low valuation for cash or property.

***Valuation.*** The per share value at the time of incorporation is determined by the amount paid for the initial purchases of stock if the stock is purchased for cash or the value of the property contributed to the company if the stock is issued for property. Thereafter, value typically is determined by sales between a willing seller and buyer or by the Board of Directors based on events and financial condition. The Board of Directors must set the fair market value at the time of each sale of stock or grant of a stock option. Successful events cause value to increase; short falls in performance cause it to decrease. Such determinations are subjective and there is no single methodology for determining current fair market value.

***Use of Debt in the Capital Structure.*** You also can partially capitalize your subsidiary with loans. For example, suppose a foreign parent creates a purchasing subsidiary in the U.S. and wants to capitalize it with $60,000. Half of this amount could be a loan and the other $30,000 would purchase the subsidiary's stock. If the parent is issued 300,000 shares of common stock for its $30,000, then the initial fair market value per share is $0.10.

Using debt generally enables the U.S. subsidiary to deduct for income tax purposes the interest payments on the debt. The subsidiary should be able to repay the principal to the foreign parent tax free and the foreign parent will be a creditor for this loan. The interest payments are subject to withholding tax unless reduced by a tax treaty. If a corporation is too heavily capitalized with shareholder loans rather than equity capitalization, however, these loans may be treated as additional equity for tax and other purposes. While maintaining a debt/equity ratio of no more than 3 to 1 is generally acceptable, if your debt/equity ratio exceeds 1.5 to 1, you may find that a portion of the deduction for interest paid to the foreign parent will be deferred until later years. Congress is considering tightening the restrictions on deductions for related party interest payments. If the ratio exceeds 3 to 1, a repayment of debt and interest could be considered a taxable dividend, and such debt may be subordinated to debts of other creditors. Extensive direct or indirect management control of the subsidiary by the foreign parent may also create such subordination.

**Securities Laws and Selling Securities**

In most instances, the sale of an interest in a business (*e.g.*, shares of stock, promissory notes, options or warrants, etc.) constitutes the issuance of a "security." Sales of securities are subject to the Securities Act of 1933, a federal law, and to state securities laws (called "Blue Sky" laws). These laws generally require full disclosure to a prospective investor and registration or qualification of the transaction with appropriate governmental authorities prior to an offer or sale. An investor can demand its money back if securities laws are not followed. There are also severe civil and criminal penalties for material false statements and omissions made by a business or its promoters in offering or selling securities. Exemptions from these registration and qualification requirements are usually available for offers and sales involved in establishing a wholly owned subsidiary in the U.S. Offers and sales to other potential investors, however, even to employees, should be undertaken only after advice from Fenwick & West's Corporate Practice Group in order to ensure compliance with such laws.

The stock purchased in a sale exempt from federal registration and state qualification requirements is not freely transferable. In addition to possible contractual restrictions, resales must satisfy federal and state securities law requirements. Resales generally may occur between foreign parties so long as you contractually restrict the stock from being immediately resold in the U.S.

**Picking a Business Name**

The name selected must not deceive or mislead the public or already be in use or reserved. "Inc.," "Corp." or "Corporation" need not be a part of the name of a California corporation but we recommend that you include one of them in your company name since some states require such a designation. Name availability must be determined on a state-by-state basis through the Secretary of State. Several alternative names should be selected because so many businesses have already been formed. Exclusive state rights in a trade name can also be obtained indefinitely through the creation of a name-holding corporation, a corporation for which articles of incorporation are filed but no further organizational steps are taken.

It is wise to do a trademark search before selecting a company, product or domain name. Otherwise, you may find that you cannot use your company name as a trademark because it is confusingly similar to someone else's trademark.

Corporate name reservation fees range from approximately $10 to $50 per state for a reservation period of 30 to 60 days. Creation of a name-holding corporation, including filing and legal fees, costs approximately $3,500 per state. Maintenance of a name holding corporation costs approximately $1,500 per state per year.

**Qualifying to Do Business in Other States**

If you intend to rent an office or warehouse in another state, or if you have employees who are authorized to accept orders on your subsidiary's behalf or who perform services (other than the solicitation of orders) within that state, you may need to "qualify" to do business there. States are becoming more aggressive about requiring qualification even for low levels of business contact because qualification generates revenue. Qualification is a relatively simple "mini" incorporation process. The consequences of failing to qualify, when required to do so, range from fines to not being able to enforce agreements entered into in that state. The cost of qualifying is approximately $1,000 per state. Some states, like Nevada, also charge a fee based on authorized stock, so the fee could be higher in such states.

**Approvals and Notice Filings**

No specific state or federal government approval is normally required for a foreign company to do business in the U.S., although the rules governing any start-up are applicable. The rules and filings pertaining to foreign acquisition of U.S. businesses involving national security, governed by the "Exon-Florio Amendment," usually will not apply when a foreign company establishes a California subsidiary. Several notice filings, however, may have to be made by the new company when sales of securities are made to the foreign company. You must file a Form BE-13 with the Bureau of Economic Analysis of the Department of Commerce within 45 days of the purchase of securities by the foreign parent. An exemption from the more onerous filing is available if the initial purchase by the foreign company is less than 10% of the outstanding stock, or if each of sales, total assets and net income of the U.S. company immediately after its establishment is $3,000,000 or less and it owns less than 200 acres of U.S. land. Most foreign-owned subsidiaries initially fall within this exemption.

An information return must be filed with the IRS when the U.S. subsidiary files its annual tax return if there have been business transactions (such as a license or distribution agreement) between it and its foreign parent. Additional IRS filings are required when U.S. real estate is transferred to or acquired by the U.S. subsidiary and when the U.S. subsidiary is a real property holding corporation.

**Federal and State Tax Considerations**

***Federal Taxation.*** A foreign company may be subject to U.S. federal withholding tax on royalties received from technology licenses in the U.S. and on income derived from a U.S. branch office.

The U.S. subsidiary must comply with all federal, state and local tax laws. A corporation is taxed as a separate legal entity. Income taxed at the corporate level is taxed again at the shareholder level if any distribution is made in the form of a dividend. The current maximum federal corporate tax rate is 35%. Any dividend to the foreign parent is subject to a 30% withholding tax unless a tax treaty provides for a lower rate. This tax liability can be reduced by carefully allocating the parent's investment between debt and equity so that the same remittances can be characterized as a repayment of principal.

The business relationship between the foreign parent and U.S. subsidiary must be clearly defined and documented to keep the legal identities separate for both tax and liability purposes. For example, the subsidiary should have a distributor, sales representative, licensee or other relationship with the parent, each reflected in a written agreement. Transactions between such related parties must reflect arm's-length pricing or the IRS may try to reallocate income between the parties for U.S. tax purposes. Royalty payments from the subsidiary to a foreign parent are subject to a 30% withholding tax in the U.S. unless reduced by a tax treaty. Your questions regarding federal or state tax issues can be resolved by Fenwick & West's Tax Group, which has an international reputation for expertise in domestic and international taxation.

***State Taxation.*** Most states impose a sales tax and an income tax. A sales tax is a tax based on the sales price of a product while an income tax is based on the income over an annual period made from such sales after deducting allowable expenses. The current California corporate income tax rate is 8.84%. California taxes a portion of a multinational corporation's worldwide profits even if its California corporation or branch office has no profits on its separate books unless a "water's edge" election is made. The California Supreme Court in *Barclays Bank v. Franchise Tax Board* upheld the constitutionality of determining the California tax on foreign corporations based on worldwide profits. When a California corporation and its parent are part of a "unitary" business, the worldwide income subject to tax in California is generally determined based on the average of the following ratios: (1) payroll in state/total worldwide payroll; (2) value of property in state/total value of property held worldwide; and (3) two times the dollar amount of sales in state/total worldwide sales. The percentages are summed, divided by 4 and multiplied by worldwide profits to calculate the amount considered to be subject to California taxation. For example, if the percentages are 8% payroll, 4% property and 10% sales (2x10%=20%), then the California percentage factor is 8% (32%/4), and 8% of worldwide profits are taxed in California at a rate of 8.84%.

Once you have begun operations in California, you can reduce the amount of tax payable to California by changing the location of your operations (*i.e.*, eliminating California payroll and property). You cannot, however, avoid the California tax merely by reincorporating in another state such as Delaware or by creating a separate subsidiary to try to segregate California earnings from those of the foreign parent or other U.S. subsidiaries.

Two or more corporations are considered "unitary" if either the Three Unities Test or the Dependency and Contribution Test is met. The Three Unities Test deems two or more corporations unitary if they share each of the following characteristics:

- The unity of ownership factor is met if the companies are controlled by the same person or group of persons. Holding more than 50% of the stock of a corporation is control.

- The unity of operation factor is met if the operation of one corporation affects the operation of the other. Significant intercompany sales, common marketing, purchasing and retirement plans or centralized financing and advertising operations indicate unity of operations.

- The unity of use factor is met if the corporations have common officers, or if the management of one corporation is involved in the day-to-day operating decisions of the other corporation.

The Dependency and Contribution Test determines if two corporations are unitary by examining the impact of the business of one on that of the other. If a significant difference would occur in the business operations of either in the absence of the other's contribution, the corporations are considered unitary. A characteristic of a unitary business is that there is mutual interdependence and there is a flow of value between the companies.

To avoid the application of this unitary method on a worldwide basis, a California corporation may elect to be taxed under the "Water's Edge Method." The election fee for the Water's Edge Method was eliminated in 1994. Under the "Water's Edge Method" the corporation must agree to be taxed on the "Water's Edge Method" for seven years and pay an annual tax on the portion of its total U.S. profits allocated to California under the three factor formula. The tax calculation is the same as above except the apportionment factor for California is calculated for U.S. operations only, instead of worldwide operations.

**Immigration Law**

The Immigration and Naturalization Service (INS) regulates the entry of foreign nationals into the U.S. The B-1 "business visitor" visa permits non immigrants on the payroll of a foreign company to enter the U.S. for short trips to conduct certain types of isolated business activities, such as negotiating an agreement, looking over an investment, or attending meetings.

Persons entering on a B-1 visa may apply for extensions of stay in six-month increments or for a change to a different non-immigrant status. Alternatively, persons from certain countries, including the United Kingdom, Japan and the Western European countries, may enter the U.S. temporarily under the "visa waiver program," which permits entry without a visa for up to 90 days, without the possibility of extension or change of status. Special rules apply for Canadians.

Canadian or Mexican nationals who are members of the professions and have the required degree and/or experience listed in the NAFTA Treaty may be employed in the U.S. in one-year increments. Canadian "TN applicants" may obtain TN status very quickly by applying at the U.S. border. The applicant must present proof of Canadian citizenship, a letter from the U.S. employer describing his or her job offer and documenting the applicant's qualifications as a TN professional, copies of relevant degrees, and an application fee. Persons already in the U.S. may obtain TN status by applying to INS for a change of status. You also can extend TN status by applying directly to INS rather than leaving and reentering the U.S. to obtain a new period of stay in TN status. There is no set limit as to how many times TN status may be extended; however, requests for extension beyond four or five years may raise the issue of whether the TN employee has maintained the requisite nonimmigrant intent.

For longer stays during which a foreign person is to be employed by a U.S. company (including a subsidiary of a foreign company), the H-1B, L-1 and E visas are typically used.

The L-1 visa is available to a person who has, during the three years immediately preceding the date of his visa application, been employed abroad for at least one year by a foreign company and who is being transferred to the U.S. to work for the same or an affiliated company (including a branch office or subsidiary) in a capacity that is managerial or executive or that involves "specialized knowledge." The latter term refers to special proprietary knowledge of the employer's product or service and its application in international markets or an advanced level of knowledge of the employer's proprietary processes and procedures. L-1 visas may be issued to executives and managers for up to seven years although specialized knowledge transferees are limited to five years. Foreigners transferred to a newly formed U.S. company initially are granted L-1 visas for only one year; L-1 visas for executives and managers may be extended only if the company has a sufficient number of employees and revenue. There is no specific minimum capital investment in a U.S. company required for L-1 eligibility, but a rule of thumb is that the U.S. company must have enough capital for its first year of operation and have leased or purchased space for its U.S. office.

Generally, an individual will qualify for an H-1B "temporary worker" visa if he has, and the position offered requires, at least a bachelor's degree (or equivalent experience). The position must be offered by a U.S. employer (including a subsidiary of a foreign company) and must be in an occupation, such as engineering, mathematics or the physical sciences, that requires the theoretical and practical application of a body of highly specialized knowledge. Thus, engineers and systems analysts would generally qualify, whereas non-degreed technicians may not. Holders of an H-1B visa may stay in the U.S. for up to six years. Prior to petitioning for an H-1B visa, the employer must file with the U.S. Department of Labor a "labor condition application" containing a representation that the H-1B holder will be paid at the higher of (i) the actual wage level of similarly situated employees or (ii) the prevailing wage level for the occupation in the area where actually employed.

The E-1 "treaty trader" and E-2 "treaty investor" visas are generally available to companies whose majority shareholders are nationals of Australia, Japan, the United Kingdom, and certain other countries that have a treaty with the U.S. These visas are for persons who desire to enter the U.S. in order to be employed in a managerial, executive, or "special skills" capacity. In addition, they must be employed by an active business that represents a substantial investment in the U.S. or is engaged in substantial trade between the U.S. and such country. Startup and unprofitable operations may not be deemed sufficiently "substantial" to qualify for an E visa. E status may generally be extended indefinitely, in two-year increments.

The costs and processing times for H-1B, L-1 or E visas are generally comparable. While E visas may generally be renewed indefinitely, L-1 and H-1B visas are limited in duration. Transferees holding an E or L-1 visa can more quickly and easily switch (adjust) to permanent resident status after entering the U.S. Fenwick & West will be happy to refer you to immigration lawyers who can help you regarding immigration issues.

**Employment Law**

Federal and state statutory and judge-made law govern the legal relations between employers and employees in the United States. There are rules against discrimination, rules regarding terms of employment and general requirements with respect to wages, hours, safety and health that apply to every employer in the United States. More recently, federal law has expanded into the areas of protection for disabled workers, required leaves of absence for illness of the worker or his family, and notice requirements for plant closings or large-scale layoffs. A number of individual states, including California, have enacted additional laws affording enhanced protection for employees and imposing increased regulation upon employers in the area of discrimination, wage and hour law, and safety and health. Any business establishing a presence in the United States must understand the applicable federal and state rules in order to assure compliance with all applicable laws and regulations.

In general, U.S. employers must look to state law to determine the requirements and consequences of employee termination, the validity of noncompete agreements with former employees, and the need for invention assignment agreements between employees and their employer. California has long had a reputation of being particularly liberal with respect to employee rights. For example, employers are prohibited with very few exceptions from contractually limiting the right of former employees to compete in California. Even including a noncompete in an employment agreement with a Californian resident can be an unfair trade practice that could subject the company to substantial damages. California law also contains a presumption in favor of "at-will" employment, a result of which is that written employment agreements are the exception, rather than the rule, for all but the highest level employees. Unlike many other countries, absent a collective bargaining agreement, most U.S. employees are not guaranteed any minimum amount of vacation time or severance upon termination.

The 1986 Immigration Reform and Control Act (IRCA) requires U.S. employers to verify the identity and employment authorization of all new employees, regardless of nationality. Therefore, you must examine the required documents establishing the identity and authorization to work in the United States for each and every new employee on the first day of employment. If the employee is authorized to work, but is unable to present the required document(s) within three business days, he or she must present a receipt for the application of the documents within three days of employment and the actual documents within 90 days of employment.

Employment of persons unauthorized to work in the United States and/or failure to comply with the employment verification requirements may subject you to fines and, in the case of a pattern or practice of hiring or continuing to employ unauthorized aliens, possible criminal penalties.

The immigration laws of the United States govern the hiring and employment of foreign nationals. Obtaining the proper visa depends upon careful compliance with the complex regulations governing immigration. If you intend to hire foreign nationals, you should seek legal advice well before the anticipated hiring date. As discussed above, you will be required, prior to the commencement of employment, to verify, obtain and retain documentary confirmation, that foreign nationals are authorized to work in the U.S.

U.S. employment law is varied and complex, but should not be an undue burden unless it is ignored. Fenwick & West's Employment Law Group can address your questions on employment law issues. Its lawyers can help you take appropriate steps to ensure compliance at the outset so that you can avoid expensive consequences later on.

**Employee Benefit Plans**

***Employee Stock Plans.*** U.S. technology companies often establish employee stock purchase and stock option plans to provide equity incentives for employees. Cash flow constraints often mean that start-up employees will be asked to accept below market salaries to conserve cash. Equity plans allow the employees to share in the company's growth and counter-balance below-market salaries. In an area like the "Silicon Valley," where most companies offer some type of equity incentive plans, even companies that can afford to pay market salaries may have to offer equity plans to attract the employees they want. Typically, 10 to 20% of the outstanding shares are reserved for employee plans.

It is often difficult for a U.S. subsidiary of a foreign company to provide equity incentives to employees because the foreign parent owns all of its stock. For this reason, the U.S. subsidiary may establish a phantom or contingent stock arrangement that mirrors the performance of the U.S. subsidiary's earnings.

Subsidiary-parent relationships can make calculating stock value difficult, but we can assist you in selecting appropriate assumptions and specifications for a phantom or contingent stock plan. In addition, it is possible to offer stock or options to buy stock in the foreign parent to the employees of the U.S. subsidiary. These cross-border equity arrangements can be complex, however, because the laws of two countries must be considered at the same time. Additional tax considerations in both countries also need to be examined.

***Section 401(k) Plans and Other Tax Qualified Arrangements.*** U.S. tax law provides certain tax benefits upon the establishment of Section 401(k) plans and other profit sharing arrangements for your employees. A Section 401(k) plan is often needed to remain competitive with other U.S. companies. These plans or arrangements permit contributions to tax-exempt trusts for the benefit of employees; employees generally receive these amounts, plus earnings, upon their termination of service with the subsidiary.

For the most part, contributions come from employee salary reductions, but are often supplemented by matching employer contributions. The employee contributions are always fully owned by employees or “vested.” The employee’s rights to employer contributions vest in accordance with a schedule based on years of service with the U.S. subsidiary. Usually, full vesting occurs after six years of service.

***Other Benefits.*** U.S. subsidiaries usually establish medical, life insurance and disability arrangements for employees. The benefit package provided varies from company to company. Fenwick & West’s Employee Benefits Group can help you set up appropriate benefit packages for your company.

## Conclusion

The United States is a lucrative market for foreign technology companies. It is relatively free of quotas and non-tariff barriers, is open to imports, and has well developed distribution channels to customers who are accustomed to buying and using technology products. This booklet addresses many of the key business and legal issues you should consider in planning your U.S. strategy. Fenwick & West LLP has represented many foreign technology companies and their U.S. subsidiaries. We would like to assist you in successfully entering the U.S. market.

www.fenwick.com

Lawyers who get IT.™