

General Business Law

Legal Risk Management Strategy for Foreign Companies Operating in the U.S. *September 2007*

The legal and financial risks associated with operating any business are increased when that company begins operations in a foreign country. The good news is, these risks can be controlled or avoided through a good legal risk management strategy. Because many problems associated with expanding operations to the United States involve its complicated legal system, it is recommended that a foreign parent work with a U.S.-based attorney experienced in assisting foreign companies with such matters.



A foreign company subjects itself to U.S. law and jurisdiction when it establishes “minimum contacts” with the U.S. For a foreign business entity, these “minimum contacts” will typically consist of sales to U.S. customers, entering into contracts or joint ventures with a U.S. partner, or marketing to U.S. customers.

The most common basis for insulating the foreign parent company from the laws and jurisdiction of the U.S. is through the formation of a limited liability company, corporation, or some other subsidiary which limits the parent

company’s liability. A parent company transacting all of its U.S.-based business through its U.S. subsidiary will normally be excluded from liability resulting from the subsidiary’s wrongful acts or omissions. Likewise, the subsidiary’s liability will be limited to the extent of its own assets. For this reason, the parent should avoid conducting business transactions directly with U.S. entities or U.S. customers.

However, these risks are not eliminated by the mere formation of a subsidiary. To reap the benefits of this organizational structure, U.S. law requires certain formalities to be followed. The protection offered by the subsidiary is dependent upon 1) sufficient capitalization, 2) the separation of its employees, 3) maintaining the subsidiary’s independence, and 4) adhering to corporate formalities.

In order to avoid any accusations of the subsidiary being merely a “shell,” it must maintain enough capital in its bank account to sustain its operations. If this requires a loan or line of credit, always ensure the subsidiary is the official borrower. Always keep the funds of the subsidiary and parent in separate accounts. Make sure any funds transferred from the parent to the subsidiary are categorized as capital contributions or loans, and that they are documented as such.

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SPAIN HASTINGS WARD CAREY & CHAMBERS

909 Fannin Street, Suite 3900
Houston, Texas 77010
Phone: (713) 650-9700
Fax: (713) 650-9701

11806 Barker Cypress
Houston, Texas 77433
Phone: (281) 373-0270
Fax: (281) 373-0271

3755 Capital of Texas Highway, Suite 100
Austin, Texas 78704
Phone: (512) 445-0001
Fax: (512) 329-0071

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An employee should either be an employee of the parent company or the subsidiary; not both. Similarly, the two companies should have a separate, non-overlapping board of directors. All corporate decisions affecting the subsidiary should be made by the subsidiary's corporate apparatus rather than by the parent directly.

Transactions between the parent and subsidiary should be transacted at "arm's length." If the subsidiary will act as the parent's U.S. distributor, there should be contractual arrangements between the two, similar to those which one would expect to see between the parent and an independent distributor. This arrangement should spell out the rights and duties of each party and provide a commercially reasonable compensation to the subsidiary for its U.S. sales. If customer support, service, maintenance or similar services are provided by the parent, the subsidiary should purchase these services from the parent for a commercially reasonable consideration. Transactions between the subsidiary and U.S. third parties should be done by agreement of a contract between the subsidiary and that third party.

It is also important to comply strictly with all corporate formalities. The subsidiary's board of directors and annual shareholder's meetings should be carefully documented with all important decisions being recorded as board resolutions. To the extent that the parent controls the subsidiary, it should do so pursuant to its rights as a shareholder and in accordance with U.S. law and the bylaws of the subsidiary.

Liability insurance can be one of the most cost effective methods of controlling the costs of any litigation brought against the subsidiary. U.S. insurance companies provide commercial general liability policies that provide broad coverage for commercial liability, including the insured's right to a legal defense at the insurer's expense. The mere possibility that a claim against the subsidiary may be covered by the policy obligates the insurer to undertake the defense, and all of its costs. This is true even if it is ultimately determined that the claim was not covered by the insurance policy.

Doing business in the U.S. can provide a foreign company a significant competitive advantage over its foreign counterparts as well as U.S.-based companies. To secure these advantages, it is essential to prepare and implement a legal risk management strategy which effectively keeps the parent company independent from its subsidiary.

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