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An Introduction to the U.S. Legal Framework

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General Factors.

Your business has performed its market entry analysis, and hopefully you have prepared a business plan. You considered which markets best fit your growth strategy, and you have considered how to implement that strategy, taking into account factors unique to your company that will increase market share and increase revenue. You likely assessed the various kinds of entry types, depending on the product that your business offers: will you be exporting to the market, licensing your specialized know how (your IP) to a local partner, franchising, engaging in some type of foreign direct investment, entering a strategic alliance with a local entity, or using some other type of specialized mode of entry? If you have a product that you want to sell, have you considered various methods for getting your product in the stream of commerce: some kind of agency deal with a local representative, or perhaps a distributor – or possibly even hiring local employees or sending one or more of your own employees to open a sales office and oversee the business? Each of these business factors noted above comes with its own set of risks and legal (and tax and accounting) issues. Assistance from experienced local (U.S.) legal counsel is essential to ensure these tasks are performed correctly so that entry risks are to some extent reduced.

Engaging U.S. Legal Counsel.

As an early step in entering the U.S. market, the non-U.S. company will need to engage a U.S. law firm to handle its legal affairs (more about what those are follows). Just as your company wisely would conduct due diligence of its potential business partners, it is essential that it also perform due diligence of law firms before engaging local counsel. I strongly recommend that your company engage a law firm that has lawyers who are licensed to practice law (that is, members of the Bar) in the state where you company is going to establish its local presence. This is because in our U.S. federal system,

which consists of 50 states, the majority of legal issues that a company entering the U.S. market faces is governed by state law. The good thing is that there are more general similarities than differences between states' laws, as laws in most U.S. jurisdictions are based on the old English "common law" (versus the "civil law" in European countries). Most of the differences in the laws of various states are in the *details,* and these are important. There also exist major differences in particular *areas* of law in which only a lawyer who is licensed in that particular state jurisdiction is competent to advise and practice.

Your company will want qualified lawyers servicing your company's needs, but you also will want to establish trust quickly and be able to communicate freely with legal counsel. Your company needs to feel comfortable that legal counsel has your company's best interests in mind. Cultivate a comfort level with your legal counsel that demonstrates that he or she cares about your company's success and wants to be part of your problem solving business team. There are a variety of means for finding U.S. local legal counsel, but most often it is by word of mouth from someone you may know who has experienced positive results. A company also can consult local business associations, chambers of commerce, economic development and trade organizations, and other sources that know, and are confident in, particular local legal counsel.

When interviewing prospective legal counsel, one of the factors you will want to explore is the firm's depth of expertise – not size of the firm but, instead, whether the firm includes lawyers that can cover most of the key substantive areas of the law that will be relevant: corporate, transactional, intellectual property, labor and employment, immigration, specialized regulatory expertise (e.g., food and drug regulatory, export controls, etc.), franchise and distribution law, real property – the list goes on. If the law firm that you are considering cannot cover all of these areas, then you *must* inquire whether it has a network that *will* provide expertise in particular areas. At a minimum, the firm that you engage must have expertise in the substantive legal areas that are core to your planned U.S. business. For example, if you selling a product of some kind, does the lawyer know how to draft the kinds of sales contracts that you may need with respect to sales of that particular product? Of course, you also need a clear understanding with respect to the firm's billing practices: firms that overcharge or send questionable invoices are affecting their clients' bottom lines – something especially important for a small company that is just entering the U.S. market. Do not hesitate to inquire with the law firm about these factors until you are satisfied. Finally – a personal bias that I believe is proven --ensure your attorney demonstrates cultural sensitivity and an open mind to the fact that Hungarians and Americans

very often are different in the way they communicate and do things. This awareness is especially important in an international business setting so that misunderstandings are minimized.

Entity Establishment.

Knowing something about the U.S. legal system is essential for any company entering the U.S. market. One of the first conversations a company will have with its U.S. local counsel will be about whether it should establish a legal entity; and if so, then what type of entity. This can seem a daunting exercise, as each state in our U.S. federal system has its own corporate laws; and entity establishment is governed by those state laws. Corporate law pertaining to legal entity establishment is one of the areas where, although there are general similarities across the 50 states, the differences from state to state are in the details. Let me over-simplify: the most common legal entities among states are the corporation ("INC"), the limited liability company ("LLC"), and a variety of different forms of partnership (general partnership, limited partnership, limited liability partnership, etc.). None of these require minimum levels of capital or equity for entity establishment. Importantly, each of these entity forms have different rules concerning ownership and the nature of ownership interests; formation requirements, entity management, liability implications for owners, officers and directors, corporate maintenance (e.g., bylaws, operating agreements, meeting requirements), and tax treatment.

More often than not, tax treatment is the most important factor in determining the type of entity a foreign company selects. Selection of the most appropriate entity form, therefore, must include a discussion with legal counsel who doubles as a tax specialist or, more commonly, a joint discussion between legal counsel and a tax and accounting firm that has a cross-border taxation practice. Working together, they can determine which entity form (i) best fits the kinds of activities in which the company will be engaged and (ii) provides the most tax benefits. Engaging a tax and accounting firm early in the U.S. market entry process is important also for purposes of general accounting and tax maintenance (i.e., filing annual tax returns) matters. Bottom line: get expert advice – no single entity type fits all – do not rush to establish an LLC (versus INC, for example) just because someone told you that it is preferred for foreign companies establishing a presence in the U.S.

Once entity type is determined, legal counsel can do whatever is required under state law to complete the entity establishment. Some of these latter steps are, for instance, obtaining a registered agent for service of legal documents, registering the entity with the requisite state authorities (usually, the Corporate Affairs division within the Secretary of State's office), completing any required corporate maintenance documents (e.g., by-laws or operating agreement), having notice of entity establishment

published locally, assisting with applying for federal and state employer tax identification numbers (note: this step often is performed by the accounting firm that the company engages), and obtaining whatever local business licenses may be required. As part of the state's ongoing entity maintenance, business entities usually are required to file an annual registration renewal for a small fee that varies from state to state.

Business Transactions.

Every business concludes contracts of various kinds, whether to buy or to sell services or goods, to license technologies, to prevent disclosure of confidential business information, to hire employees, to establish sales representatives or distributors – you name it. Contracts memorialize commitments for the parties to perform certain obligations, whether to perform some task in a particular manner, or to pay a certain amount to the other party in exchange for that performance. They also serve as the parties' first line of defense by addressing certain "risk" issues such as, for example, defects in the product that might cause injury (products liability), or allocation of risk between the parties (indemnification). The most important principal to remember is that U.S. contracts are binding commitments that, with certain narrow exceptions, will be enforced by judicial authorities. Whatever the purpose of the contract, its obligations (or promises between parties) must be written clearly, and it must be consistent with laws. The more clearly written the contract, the less likely business conflicts arising between the contracting parties may result in some kind of litigation.

One characteristic of U.S. contracts that may differ from European contracts is the length and variety of subjects covered in a typical agreement. This results from the facts that the laws applicable to U.S. contracts generally evolved out of English common law, where a fundamental principle prevails that provides the parties "freedom of contract" – the freedom to agree to whatever they desire, providing that they do not conflict with some well-established legal principle or a subject that is governed by statute. This results often in much longer contracts than might govern a transaction concluded in a country that has a European civil law tradition, where many issues that we cover in U.S. contracts are covered in European countries by statutes. Given this freedom to contract, clarity and thoroughness is essential in contracts governed by U.S. legal principles in order to avoid disputes that may arise between parties. Litigation in the U.S. is costly, very time consuming, and often unpredictable; and a well-written contract can help avoid litigation.

Foreign-owned companies should avoid simply translating and using contracts that they may be using at home. They may serve as a starting point, but foreign companies are advised to engage U.S.

legal counsel who can assist in "Americanizing" local agreements/transactions by drafting contracts that will apply across the U.S., with some limited exceptions. Even here, there are significant differences in laws among the 50 states, so engaging U.S. legal counsel is essential for preparing contracts that will govern a business transaction in the U.S.

A few general contract areas of concern for you to note:

(i) The right to trial by jury is a right in the U.S. that is guaranteed under the U.S. Constitution. Some exceptions exist in narrow specialized areas that are carved out by statute. Parties may prefer to have a dispute adjudicated by a single judge, especially where the business matter is complex or highly technical; but that waiver of the right to trial by jury must be clearly and conspicuously agreed by the parties in the contract. Similarly, parties may prefer arbitration as offering a potentially better result: in that case, the contract drafter should insert an arbitration provision in the contract.

(ii) The contract also needs to identify the state law applicable to contract interpretation and dispute resolution (e.g., the laws of the state of Georgia will govern . . .). It also needs to include the jurisdiction where litigation will occur and whether the dispute will be adjudicated in the courts or by arbitration (e.g., the courts residing in Fulton County State of Georgia . . . [or] arbitration in Atlanta, Georgia under the x arbitration rules . . .).

(iii) Remittance and compensation provisions should be clearly crafted to avoid future disputes.

(iv) Intellectual property ownership and use provisions often are significant in contracts where technology constitutes a key part of the business deal. The contract provides the parties an opportunity to avoid future intellectual property disputes, especially in those instances where new intellectual property may be created by the parties during their performance under the contract.

(v) Depending on the nature of the business between the contracting parties, the contract may address particular "compliance" issues that are relevant to the contract obligations – i.e., matters like export controls, embargoes/economic sanctions, and corrupt practices.

(vi) As noted briefly before, contracts should address "risk allocation": if someone is injured or something is damaged during contract performance, then which party will be held

responsible for any liability that arises. Also, it might address limitations on the parties' liability.

(vii) Finally, the contract must state the conditions under which the contract terminates – whether the contract is for a specified term, whether and under what conditions it may be renewed, and how a party might terminate the contract due to breach or other occurrence.

Management and HR.

Very briefly, note a couple of important issues that need to be considered in hiring a local workforce: certain states are favored as sites for investment because they are "right to work" and "employment at will" states. Right-to-work laws are based on the principle that mandatory laws requiring employees to join a union are a violation of an individual's rights. The laws take the view that every employee has the right to decide whether they want to belong to a union or not. More than half of the states have right to work laws. "At-will" employment describes a working environment in which employers are free to terminate employees at any time, without cause, explanation or prior warning, provided it does not violate state and federal anti-discrimination laws. Similarly, employees can quit a job at any time without reason or notice. Employment contracts, which are common with managerial and specialized skills employees, often include negotiated terms that modify or limit the employer's ability to terminate employees without cause and without notice. Employers also usually have written work rules that provide additional benefits such as vacation allowances, maternity and sick leave, and bonuses.

Finally, many questions arise concerning a company's ability to bring individuals to the U.S. to manage or to provide specialized expertise to the newly established U.S. entity. Different types of visas may be available, depending on the circumstances.

In all instances, U.S or foreign businesses operating in the U.S. are advised to seek advice of qualified local counsel that practices labor and employment law and, where applicable, immigration law.

Questions?