



Investing and Operating in the United States: *Opportunities, Best Practices & Risk Mitigation for Chinese Companies*

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James A. Baker IV



Agenda and Topical Subject Matter

- **Differences In US and Chinese M&A Markets**
- **Buying, Investing, or Greenfield**
- **Due Diligence: Purpose, Scope, Organization**
- **Taxation of Business Operations**
- **Intellectual Property, Licensing, Tech Transfers**
- **Labor & Employment**
- **Regulatory Compliance**
- **Contingency Planning**
- **Wrapping Up**

Differences Between US and Chinese Markets:

Strategic considerations

- **Many investments in the US are not politically or strategically sensitive and with careful planning, can be smooth and seamless (CFIUS)**
- **Free repatriation of profits and investment capital**
- **Some sectors of the US economy remain sensitive and require specialized, longer-term strategies**
 - Telecommunications
 - Energy (electricity generation or transmission)
 - High-technology, software
 - Defense-related businesses or government contractors
 - Critical infrastructure (e.g. ports or pipelines)
 - Geographic sensitivity (e.g. Ralls-Sany)

Differences Between US and Chinese Markets: Taxation Considerations

- **The US tax regime is the most complex and far reaching system in the world**
- **Federal, state and local tax laws can impact significantly the economics of an investment**
 - Careful tax planning and structuring can mitigate negative tax effects of M&A transactions
 - Informed decision making at the outset impacting a company's tax profile is very important as these may be much more difficult or costly to resolve later
 - At the local level, states and municipalities are keen to attract foreign direct investment through an array of local tax abatements and/or other economic incentives

Differences Between US and Chinese Markets: Public Companies

- **Acquiring or listing a company on a US exchange, whether by IPO, "reverse merger", or otherwise, provides capital access but requires comprehensive regulatory and corporate responsibilities**
- **US public companies operate in a highly regulated and transparent environment**
 - US jurisdiction over business extends to many non-US activities (compliance with trade embargoes or sanctions, anticorruption laws)
 - US public companies have extensive financial and risk disclosure filing requirements intended to provide the highest degree of transparency
 - Sarbanes Oxley law imposes strict governance requirement.

Differences Between US and Chinese Markets: Litigation and Disputes

- **Litigation is a more common aspect of business conduct in the US than elsewhere**
 - Often a tactical initiative in takeovers or proxy contests
- **Usually both expensive and time consuming**
- **Unless there is a contract to the contrary, legal fees are not usually recoverable**
- **Business litigation often settles and does not reach merits in court or arbitration**
- **Increasingly some business sectors are being formed around litigation**
 - "Patent trolls"
 - Venture capital funding of plaintiff lawsuits

Differences Between US and Chinese Markets: Government Relations

- **The US federal system divides power among three and sometimes four levels of government - federal, state, local and cities**
 - Each level maintains executive, legislative and judicial branch
 - While not unique, the degree of overlap among these is much greater than in most other countries
- **Effective government relations depend on a solid record of legal and regulatory compliance, and the potential to bring benefits to economy**
 - Personal relationships are less important, even for established companies
 - Problems are rarely resolved purely through good connections

Buying, Investing, or Greenfield

Buying: Know the Target

- **Comprehensive due diligence is critical**
 - Perils of successor liability, financial mismanagement, improper payments or fraud, title to property, etc.
- **Structure and Approach**
 - Asset Purchase
 - Stock Purchase
 - Merger (Standard, Reverse Triangular or Forward Triangular)
 - Higher risks with Stock or Merger deals, but more work and higher transaction costs for Asset deals
- **Regulatory filings and approvals**
 - Securities laws, antitrust and CFIUS compliance
 - Possibly other approvals, depending on industry

Buying, Investing, or Greenfield

Investment: Picking the Right Structure

- **Corporation**
 - No US federal corporate law; each state has its own business organization laws
- **Location choice: Usually Delaware or possibly Nevada (due to flexibility and predictability) or the state where the business will have its main office or operations**
 - Delaware advantages are flexibility of the law and its relatively settled state
 - Taxes can be a key consideration at both the federal and state levels

Buying, Investing, or Greenfield

Investment: Picking the Right Structure (cont.)

- **Partnerships or Limited Liability Companies (LLC)**
 - Usually private; possibly disadvantageous to foreign owners due to pass-through tax treatment and prospect of creating US jurisdiction over the foreign owner
- **Master Limited Partnerships (MLPs)**
 - A favored vehicle for resource related companies; publicly traded; administrative complexity
- **Branch office of a non-US company**
 - In many countries, a foreign branch of your parent company has low risk, NOT in the US
 - An extension of the parent into the US subjects that company to more risk in the US (litigation, taxes)

Issues in Selecting Transaction Structure

- **Parties' respective tax objectives**
- **Seller's exit objectives**
- **Buyer's risk mitigation strategies**
- **Buyer's objectives for post-closing operation of Target business**
- **Required regulatory approvals**
- **Required approvals of other third parties**
- **Required corporate law approvals**
- **Securities law considerations**
- **Accounting considerations**

Conducting Due Diligence in the US

- **Comprehensive due diligence investigation (for example in respect of certain asset acquisitions) can be fairly costly and time consuming**
- **Many new entrants into US market commence business relationships without adequate diligence and then confront legal or publicity related issues**
- **Diligence can be an inexpensive proposition in certain circumstances, as many legal and financial records are easily accessible**
 - Corporate records, credit checks, litigation checks and UCC filings (security liens) are easy to access

Purposes of Due Diligence Investigation

- **Determine condition and quality of the company and/or assets to be acquired**
- **Evaluate viability of target's operating model, projections and assumptions**
- **Identify potential synergies or efficiencies**
- **Identify key risks and exposures and develop appropriate mitigation strategies (e.g., 3rd party consents, change in control provisions and regulatory issues)**
- **Assist in structuring the transaction and preparing acquisition documents to minimize risk**

Principal Objects of Due Diligence Investigation

- **Legal -- Regulatory, litigation, IP, material contracts, employee benefits**
- **Tax -- State and federal tax status and related issues, tax treatment of transaction**
- **Accounting -- Internal controls and procedures, auditors, accounting treatment of transaction**
- **Financial -- Books and records, financing commitments**
- **Business -- Operations of business, projections and integration issues**

Organization of Due Diligence Investigation

- **Parties involved:**
 - Internal deal teams
 - Investment bankers, if any
 - Lawyers
 - Accountants
 - Specialists as necessary (industry, environmental, insurance)
- **Locations -- online data rooms vs. on-site investigations**
- **Timing considerations -- establish deadlines but due diligence is an iterative process, to be constantly monitored and updated all the way to closing**
- **Communication is key -- important to establish team leaders and provide for a free flow of information among lawyers, bankers, accountants and internal deal team**

Taxation of Business Operations

Complex, Multiple Levels

- **US tax system is complex with federal, state and local tax regimes**
 - Taxation of a transaction or business operations can significantly impact the economics of an investment or a company, subject to careful planning or depending on incentives that may be available
- **Federal level**
 - US income tax system assesses tax at the corporate level and again at the shareholder or personal level
 - Capital gains may be taxed at reduced rates
 - Employee payroll
 - Excise taxes and duties

Taxation of Business Operations

Complex, Multiple Levels (cont.)

- **State level**
 - Usually similar to federal; some states don't impose income taxes but most have sales tax and/or property tax (real property and, in some states personal property taxes)
 - Franchise taxes assessed on many companies are usually modest but can be substantial in the absence of careful planning
 - Severance taxes for resource extractive industries
- **Tax treaty benefits**
 - 1984 PRC-US double taxation treaty
 - May be possible to benefit from tax treaties with third countries through careful structuring

Intellectual Property, Licensing, Tech Transfer

- **M&A deals increasingly focus on acquisition of patents and other intellectual property rights**
- **US system of IP rights and protections provide benefits for conduct of R&D activities in the US**
 - For companies with significant IP, ensuring protection of these assets is critical first step prior to business activities
 - Caution is advised in entering into arrangements to share IP
- **US patents have almost tripled in 20 years, and patent litigation cases have increased five-fold, reflecting increasing importance of**
 - Identifying, perfecting and protecting IP, and
 - Use of IP both offensively and defensively in disputes

Labor and Employment

- **Advisable to have employment contracts for executives, technical personnel, officers**
 - Employee secrecy and non-disclosure (subject to exceptions for key employees in public companies)
 - Useful for post-employment non-compete or non-solicitation limitations on; mitigate against wrongful termination litigation
- **For others employees, many US states adhere to "at will" rule for employment. Exceptions in various states, particularly CA or NY**
- **Collective bargaining agreements or WARN restrictions (Worker Adjustment Retraining Notice)**

Labor and Employment (cont.)

- **Collective bargaining and employee benefits**
- **Discrimination and other unlawful acts by employer - US federal and state laws apply**
 - Consider collective bargaining laws or right to work laws in various states
- **Visa/Immigration requirements for foreign employees**
 - Need to consider the risks of relying on Chinese employees of the Chinese parent company doing work in the US; may impact parent company's liability

Regulatory Compliance

- **Conduct of business in the US can be affected by range of different regulatory matters, depending on the industry or economic sector**
 - Telecommunications, transportation, natural resource or real estate development, medical or financial services, pharmaceuticals, manufacturing and others all have exposure to a regulatory matrix that may involve federal regulatory agencies and possibly state and local regulatory bodies
- **These regulatory matters are always evolving - the process can be open to public comment, but can also result in new requirements with little warning**

Contingency Planning

- **As your company scales up, bring more advisory resources into the mix**
- **Most companies wait until major crisis hits to develop crisis management resources**
 - Crisis response is intended, at best, to keep a bad situation from becoming worse
 - Response after-the-fact usually involves greater expense
- **Advance planning can yield significant benefits**
- **Emergency communication plans and strategies; crisis management to confront environmental problems, product recalls, law suits, government investigations or enforcement actions**

Contingency Planning (cont.)

- **Press and public relations, government relations**
- **Media in the US is pervasive, highly independent and thrives on negative stories**
 - Difficult to correct record once the story is out
 - Often better to preemptively lead with your version
- **If litigation is threatened or commenced:**
 - Do not reply directly (orally or in writing)
 - Immediately consult counsel

Wrapping Up

Key considerations and touchstones

- **Comprehensive and consistent due diligence of target and partners**
- **Careful tax planning and structural considerations**
- **Assume responsibility for documentation**
 - First class contracts are essential
 - Get what you want and protect from litigation or potential claims
 - Contracts are first line of defense
- **Develop and maintain IP policy and procedures**
- **Regulatory compliance**
 - Ensure pre-merger and operational compliance with federal and state level regulations (HSR, CFIUS, WARN, etc.)