ACCELERATED GROWTH CENTER

A Measure of **Québec's Export Strategy** 2016-2020

PRELIMINARY LEGAL OBSERVATIONS FOR QUÉBEC BUSINESSES EXPANDING INTO THE US

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Part 1

I. Start your US expansion on the right footing: some organizational steps

While you are developing your business plan for expansion into the US, you have the following two key organizational matters. These two matters should be addressed early on and should be addressed together.

A. Protect Canadian assets and activities

If you are engaging in frequent or significant activities in the US, you should normally use a US entity or several US entities for your US activities. That should help separate and protect your Québec company and Québec assets and activities from:

- US claims and liabilities generally
- US regulatory requirements and
- US taxes.

B. US taxes

To what extent will your planned activities in the US be subject to US tax? In general, US federal and state taxes can be triggered by carrying on a trade or business in the US.

- Your US subsidiaries will be subject to US tax on the income or gain from their activities.

What about US tax on the activities of the Québec parent? The Canada-US tax treaty generally provides that the business profits of a Canadian company will **not** be subject to US tax **except** to the extent they are attributed to a Canadian company's "permanent establishment" in the US.

A "permanent establishment" generally exists in the US if either:

- The Québec company has a fixed place of business in the US, such as an office, branch, factory or workshop or
- An agent or broker in the US exercises authority to enter into contracts on behalf of the Québec company.

A "permanent establishment" of the Québec company generally does **not** exist merely because the Québec company has one or more US subsidiaries. In other words, using US subsidiaries to hold US assets and conduct US operations helps shield the Québec parent's activities outside of the US from US tax.

II. The choice of using one US subsidiary versus several US subsidiaries

The choice will normally depend on whether you are conducting one type of business in the US or conducting different lines of business.

Using separate entities for different business units or divisions can:

- Separate activities subject to US federal or state regulation from unregulated US activities
- Separate activities that may be subject to tax in a particular state from other US activities and
- Be helpful if you later want to dispose of a particular division or want to bring in other partners/owners for that particular business.

III. You should normally organize your US entities as Delaware corporations

You can do that even if you have no activities or assets in Delaware. Choosing Delaware as the place to organize your US companies is the usual choice for non-US companies establishing a subsidiary in the US and provides you with good protections and flexibility.

A. It is simple and inexpensive to set up and maintain a Delaware corporation as a subsidiary. You:

- File a short certificate of incorporation
- Adopt by-laws
- Appoint directors and officers and
- Issue stock to the shareholder.

B. If one of your US entities is a joint venture with another partner, then you may want to set up that entity as a Delaware limited liability company (an LLC), subject to advice from your tax advisors. An LLC generally provides liability protection like a corporation but can allow tax attributes to pass directly to the owners/partners, like a partnership, and provides great flexibility to structure the rights and obligations between the owners or partners.

C. Forming an LLC requires:

- Filing a short certificate of formation and
- Entering into an operating agreement among the members.

IV. The company's tax advisers should advise the company on the following, among other things

The company's tax advisers should advise the company on:

- The best US structure of companies for tax efficiency
- The individual tax status of personnel from the Québec business who may be involved in the US business or employed full or part-time by any US entities
- How to fund the US entities; should all shareholder funding be in the form of shareholder contributions for stock or should you also use some loans from the shareholder or from other affiliates
- Plans for moving contributed capital and earnings back to Québec as needed and
- Guidelines for establishing the terms of obligations arising between companies in the overall group (the group consisting of the Québec parent, US affiliates and other affiliates), including the pricing (referred to as transfer pricing) for goods or services sold or provided to US entities by the Québec parent or other affiliates and then used by the US entities or sold or provided by the US entities to US customers; your transfer pricing should be at fair value and may be scrutinized by tax authorities.

V. You should assign someone internally to work with outside US legal counsel to satisfy the necessary formalities as far as organizing, funding and maintaining your US entities

VI. Having set up your US subsidiaries partly to shield the Québec parent and Québec assets and operations from US liabilities, you need to respect the existence of the US subsidiaries

A. That means:

- The US subsidiaries should normally take all the actions in the US
- The appropriate US entity should enter into all US contracts and US proposals for US business under the name of that US entity
- You should use an officer or employee of that entity to sign those contracts or proposals on behalf of that US entity and
- Depending on the contract, a US holding company or the Québec parent company may have to be an additional party to the contract to guarantee performance of a US subsidiary.

B. Officers of your Québec company can also be officers of your US companies. But when acting for any company, they should make clear which company they are acting for.

C. Your group's actions, documents, website and communications should not ignore the role and existence of the US subsidiaries.

D. You should satisfy corporate formalities for the US companies (such as periodic appointments of directors and officers), which are easy to satisfy.

VII. If any of your US entities conducts a sufficient amount of business in a state outside of Delaware, it may need to qualify to do business in that state (sometimes referred to as being licensed to do business in that state). Qualification in a state will generally result in paying taxes to that state

Occasional sales in a state or merely owning or leasing property is generally not enough to require qualification. If you fail to qualify to do business in a state when qualification was required, that can generally be cured by payment of back taxes with interest and potentially penalties. Qualification is usually an easy process.

VIII. If one of your US entities operates in the US under an assumed name (other than its full formal name), the entity may need to file simple assumed name certificates ("doing business as" certificates) in various local US jurisdictions

IX. Of course, entities in certain regulated industries are subject to special US federal and state requirements and restrictions regarding licensing, formation and operation, such as entities engaged in banking, insurance, brokerage, engineering, etc.

X. The US Commerce Department requires reports (BEA reports) regarding non-US investment in US enterprises

These BEA reports are required when non-US interests establish, acquire or expand a US enterprise and also are required on a continuing basis. BEA reports require that the information be presented in specified formats. The US Commerce Department is prohibited from sharing a company's BEA information publicly or with other government agencies. The information can only be published by the government as aggregated statistics together with information from others.

Part 2

I. Some relevant US laws you should know about

A. Employment Laws

Unless there is an individual employment agreement or a union collective bargaining agreement, employment in the US is generally employment "at will". That means that US employees can be terminated for no reason (as long as the reason is not discriminatory or retaliatory) and with no notice, no remedy and no severance benefits. There are a few exceptions for certain required benefits, generally described below.

No employee benefits are required to be provided in the US, except:

- Under the US Affordable Care Act (Obamacare), employers of businesses with at least 50 "full-time" employees, defined here as employees working at least 29 hours per week, must generally provide their employees with certain minimum health coverage.
- Terminated employees and their dependents who are no longer covered by their former employer's group health plans may have federal and state COBRA rights. COBRA rights generally allow terminated employees and their eligible dependents to continue to be covered under the former employer's group health plans for periods generally ranging from 12 to 36 months as long as the former employee pays 102% of the cost.
- Certain states provide for some additional specified benefits, such as paid sick leave, unpaid family or medical leave, pregnancy leave and certain rights with respect to unused vacation or sick time.

Employees may potentially have the right to receive certain benefits upon termination either:

- Based upon alleged promises contained in statements made by the company orally or in writing or
- Based upon past practices of the company, such as regularly providing certain severance benefits to terminated employees or
- Because the employer has voluntarily adopted benefit plans or entered into union collective bargaining agreements or individual employment agreements, each of which may require that specific benefits set forth in the plans or agreements must be provided to specified groups or individuals.

If a group of employees is terminated, whether as part of a general layoff or a facility shutdown, US federal and state WARN Acts may require the employer to give certain advance notice to the employees.

While there generally are no required employee benefits that must be provided in the US, other than as described above, if benefits are provided then both the US ERISA law and the US Internal Revenue Code (federal tax law) can impose numerous requirements on employers.

Claims and lawsuits related to employment in the US can cause companies to pay substantial amounts of money. The following types of claims can be particularly troublesome for an employer:

1. Claims of discrimination in employment-related actions, such as in hiring, firing, training, promoting, demoting, etc. These claims may be brought under federal or state anti-discrimination laws that prohibit discrimination based on race, color, sex, religion, national origin, pregnancy, disability, age and many other prohibited reasons. These laws also protect employees against sexual harassment. Similarly, US employees may be protected against bullying or an unsafe work environment.
2. Claims of improper classification of employees, as full vs. part-time, as employee vs. independent contractor and by type of employee. These claims may be brought under various US employment laws requiring minimum wage and overtime or addressing other matters, where the classification of personnel significantly impacts how the law applies.

US employees are entitled to various protections against retaliation in employment-related decisions, such as retaliation for expressing concerns about health or safety risks or possible fraud.

US employment law counsel can help the company administer US employment matters to minimize and manage US employee claims.

B. Intellectual Property Rights

US procedures to protect intellectual property (IP) rights are different in various respects than the procedures in Canada. The company should analyze carefully the protections available in the US for trademarks, copyrights, patents and trade secrets to determine how best to protect the company's IP in the US.

As part of its IP strategy in the US, the company may need some of its personnel to enter into certain written agreements in favor of the company, such as a confidentiality agreement or an assignment of rights to ownership.

C. Antitrust Laws

Certain agreements and conduct, wherever they may occur, that may lessen competition in the US or abuse market power in the US can expose the company and its personnel to criminal violations of the US antitrust laws and substantial penalties.

US antitrust law is similar to Canadian antitrust law but is not the same.

US legal counsel should provide your management and your personnel who will be dealing in the US with basic US antitrust compliance training.

D. Compliance Programs

There are substantial advantages in having an effective US compliance program. An effective compliance program can of course lessen possible violations of US laws. In addition, if the company is charged with a violation of US laws, then an effective compliance program can provide the company with:

- A possible defense against various US claims and
- A possible reduction of US penalties for violations.

An effective compliance program requires:

- A well written policy
- Effective compliance training for personnel
- Effective methods to report and uncover possible violations
- Thorough investigation of possible violations
- Prompt action to remedy violations, including appropriate disciplinary action
- Internally consistent messages from the top of the company regarding the importance of the compliance policies
- Review by appropriate senior officers of the operation of the policies and
- Occasional audits to test the effectiveness of the policies.

E. Environmental Laws

Environmental protection laws in the US are administered at the federal, state and local levels.

Various contaminated locations in the US, including land, buildings, plants, warehouses, testing sites, etc., have been designated by the US Environmental Protection Agency as federal Superfund sites, and new sites are sometimes added to the list. Owners and operators of these sites can be liable for prior contamination at or from the site.

When certain types of contamination or pollution are discovered at a location (whether discovered accidentally or as a result of testing), applicable US law may require that the contamination be reported immediately to government agencies.

F. Securities Laws

The approach to securities regulation in the US is different in various respects than in Québec. Securities laws in Québec and the US use many of the same words, but those words may not have the same meaning. The definition of a "security" is broader in certain respects in the US than in Québec, and certain types of transactions that require securities registration or an exemption in the US may not be subject to regulation in Québec. The US also sometimes takes a very broad view of the types of contacts with the US that will justify the application of US federal securities laws.

US securities law regulation governing the offer, sale, resale and trading of securities is dominated by the complex and continually evolving US federal securities laws administered by the US Federal Securities and Exchange Commission. In addition, state securities laws may apply in certain situations.

If your Québec parent company or your US entities offer or grant any securities to officers or employees of the US entities or to other persons in the US, including stock options and restricted stock, you should consult with US legal counsel to ensure that the actions comply with or are exempt under US securities laws and are properly documented.

G. US Election Laws

Corporations are prohibited from making contributions (anything of value to influence an election) in connection with a US federal election.

Corporations are allowed to establish Political Action Committees (PACs), subject to numerous requirements and restrictions. PACs can solicit donations from the employees and stockholders of the sponsoring entity, and the PAC can then contribute those monies, up to a maximum permitted amount, to a federal candidate or election committee.

US law prohibits non-US persons, whether individuals or entities, from directly or indirectly contributing or making any expenditure in connection with US federal, state or local elections.

This means that the Québec parent company:

- Cannot participate in or influence in any way decisions by a US subsidiary regarding whether to make political contributions
- Cannot be involved in the creation or operation of a PAC established by a US subsidiary and
- Cannot fund or reimburse permitted US political contributions made by a US entity, by a PAC or by US individuals.

Corporations and non-US persons may be permitted to make contributions to certain committees advocating for policies that are not connected to a particular candidate.

H. Export License Laws and Sanctions

Certain US origin goods, technical data and services relating to munitions or military use or having dual commercial and military use cannot be exported outside of the US or provided to non-US persons without a special license.

US persons cannot facilitate or assist in contracts or dealings with certain targeted individuals or targeted countries against which the US has imposed sanctions. This applies to US citizens and permanent US resident aliens (wherever they are located or working) and includes US entities and in some cases their non-US subsidiaries.

I. Investment Compagny Act

US companies that hold too large a percentage of their assets in securities can inadvertently be required to register and become regulated under the US Investment Company Act, which should be avoided.

J. Liens

Procedures for protecting security interests or liens on property in the US are different than the procedures regarding a hypothec in Québec.

K. Acquisition Filings

In connection with acquiring a business in the US, the US Hart-Scott-Rodino Act may require specified antitrust filings by both buyer and seller. Subject to various exceptions, these HSR filings may be required if the value of the transaction is more than US$84.4 million.

An HSR filing requires information to help antitrust authorities assess the potential impact of the transaction on US competition and also requires that the filing parties provide copies of various types of internal and external documents and communications analyzing the proposed transaction.

After the HSR filings have been made by both buyer and seller, the US antitrust reviewing agency has a specified period (referred to as the waiting period) to review the transaction and consider its impact on US competition. The closing of the transaction may not occur until the applicable waiting period has expired.

A transaction may also be reviewed by the Committee on Foreign Investment in the US (CFIUS). CFIUS is a US federal multi-agency committee. A CFIUS review considers whether a non-US person will be permitted to acquire control over US assets that may have potential national security importance, broadly defined. Based on the CFIUS review of a transaction, the US President can block or unwind the transaction, before or after it closes.

L. Miscellaneous

The company should generally understand the restrictions and procedures regarding:

- Immigration into the US
- US customs and other applicable trade requirements for goods and services coming into and going out of the US
- Any labeling requirements regarding the packaging of goods sold in the US and
- Applicable requirements regarding lobbying in the US.

II. Contracts in the US: Some basic things you need to know

You should normally choose New York law as the governing law for your US contracts. Local companies in other states may want their state's laws to govern, but New York law is generally the best as far as protecting the reasonable expectations of the parties. Other states' laws may contain aspects of local social policy or unpleasant surprises.

In connection with contracts for the sale of goods, state laws are uniform on many key points because all the states, except for Louisiana, have adopted Article 2 of the US Uniform Commercial Code (UCC), with some differences from state to state.

Article 2 sets out many terms governing a sale of goods, including rights, obligations, remedies and damages. Most of the terms in Article 2 can be changed by contract. Even though the states have adopted Article 2, it still is usually best to choose New York as the governing law for the sale of goods in the US because:

- The version of Article 2 adopted by New York is a favorable version as far as protecting the reasonable expectations of the parties and
- Article 2 does not address some significant contract issues that may arise in a contract for the sale of goods, and in those cases, general New York contract law is generally desirable, especially for a seller of goods.

You should consider the advantages and disadvantages of having any disputes under your contracts governed by litigation versus arbitration, with or without mediation.

If you use arbitration to resolve contract disputes, you would normally want to provide that the arbitration will be located in an area that has many capable arbitrators available, such as New York or Chicago, and that is convenient for the parties.

If you are going to resolve disputes by litigation, you normally want to submit to the exclusive jurisdiction of New York courts to apply New York governing law. New York courts generally are sophisticated and experienced. Courts in various other states may sometimes give their local companies in that state a "home court advantage" which could hurt a Québec-owned company.

When you submit to jurisdiction of courts in a particular state for litigation, you should try to submit to federal court jurisdiction in a major metropolitan area and to state court jurisdiction only if federal jurisdiction is not available. For example, in most cases, you would ideally want litigation resolved in federal court in the borough of Manhattan, New York, New York, or if no federal jurisdiction is available, then in state court in Manhattan.

US legal counsel should help you develop model contracts or templates. US contract law differs from Québec or other Canadian contract law in many ways as far as contract interpretation, the meaning of certain terms and what language best protects a party with respect to rights, obligations, disclaimers, remedies, damages and other matters.

Matters covered in this brief summary and other points are discussed in greater detail in the memorandum "Some Legal Considerations for Canadian Companies Expanding into the US".