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FOREIGN SALES, DISTRIBUTION, LICENSING AND JOINT VENTURE AGREEMENTS*

BY MARCELLUS R. MEEK† AND IVAN R. FELTHAM††

THIS ARTICLE will review certain of the elementary and practical aspects of foreign sales, distribution, licensing and joint venture agreements. These are often regarded as the four stages of penetration into foreign markets. How often is it said that a company with foreign sales prospects should get its feet wet with experience in direct exporting, then find a reliable independent distributor to gain greater penetration of the market, thereafter venture more or less timidly into manufacturing by licensing patents, technical data and technology and finally take the plunge into a joint venture or wholly-owned manufacturing organization?

The four-step penetration has proven successful for many companies. Yet, it is unwise to think of the stages as necessary steps for penetration into foreign markets. A company that has never exported may well find a suitable opportunity for manufacturing abroad without preliminary foreign market penetration. However, this will be unusual without first testing the market. The more likely possibility is that a company which has established the acceptability of its product or products in a foreign market will go directly into manufacturing abroad without the licensing "stage" which is so often thought of as a useful or even necessary preliminary since it increases foreign experience with a minimum of investment. It certainly does that, but it also involves

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loss of control over technical data and technology. No matter how tightly drawn the license agreement, once secret information is released it is no longer secret. Further, a licensee is a potential competitor, particularly in view of the United States antitrust restrictions on preventing a licensee from exporting his manufactures to the United States market.[1] The attraction of quick royalty returns must be carefully considered in the light of long-range plans for foreign operations. These points will be expanded later in this article.

In this discussion of distribution and foreign manufacturing, our emphasis will be on how to get the commercial job done, but within the framework of existing laws and regulations, both in the United States and foreign countries. It used to be that we were concerned only with domestic laws and local foreign laws. Now we must also consider super laws, that is, the laws promulgated by various organizations of states which are superimposed on the already complex laws of the individual member states.[2] We shall discuss only the more salient points which arise when a company enters into one or another type of overseas business arrangement. This may take the form of a direct export sale of a product by the United States manufacturing company, manufacture of the product by a third party abroad under a license arrangement, or manufacture abroad by a foreign branch, a subsidiary, or a foreign joint venture.

EXPORT SALE CONTRACTS

We start with direct export sales. They are perhaps the simplest and easiest to deal with, since there is no need to consider problems of manufacture. Our primary inquiry should be how best to put the product into the foreign customers' hands. Development of the market being the most important objective, the person or the company not experienced in foreign trade will wish to review the tools available to assist him in this task. Depending upon the nature of the product, marketing may be handled directly by the United States manufacturing company through its own employees, or through a system of distributors located in various countries of the world.

[1] *See* BREWSTER, ANTITRUST AND AMERICAN BUSINESS ABROAD (1958).

[2] *See* A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS (SURREY & SHAW ed. 1963).

In considering market development, we mention that advertising is, of course, very important. Trade journals are a good source of new interest from foreign industrial markets. But again, the nature of the product has a bearing on what will be most successful. In some cases, international trade conventions and trade fairs prove effective in introducing a product to world markets.

Other than the methods one might employ in developing overseas interest in one's product, there is very little more that need be said about direct sales in foreign markets handled by employees of the United States manufacturing company. For a company not experienced in foreign trade, shipping procedures seem complicated and difficult, but they are not in fact. Any good freight forwarder or shipping agent can handle all the details with a minimum of strain on the manufacturing company's personnel. The *Exporter's Encyclopedia*[3] is in and of itself a complete export shipping guide. Several other publications are available. For instance, The *Foreign Commerce Handbook*, which is published by the Chamber of Commerce of the United States, contains very useful information and source material. The United States Chamber of Commerce also publishes an *Introduction to Doing Import and Export Business*. It, likewise, can be helpful. We should not overlook the aid which may be obtained from the United States Department of Commerce. This department distributes an "Export Kit" which is useful.

With the foregoing brief introduction, we turn to some legal considerations which should be borne in mind in connection with export contracts. We shall concentrate on the legal relations between the exporter and the importer. Although the contractual aspects are generally straight forward and differ very little from domestic contracts, there are a number of points which require special attention because of the fact that an export contract by its very nature involves at least two different legal systems. We shall refer from time to time to Canadian, English and other foreign rules with which a domestic exporter may expect to be concerned.

We shall concentrate on avoidance of problems rather than on the legal rules which may apply after a problem has arisen. There is a difference in emphasis between problem avoidance and resolution of

[3] EXPORTER'S ENCYCLOPEDIA, DUN & BRADSTREET, annual.

existing disputes.[4] Problem avoidance requires cognizance of potential problems and careful planning to reduce to a minimum the possibility of dispute, while resolution of disputes requires analysis of issues which have already arisen, it being too late to steer clear of them by planning. A discussion of a number of important points follows.

Completeness and precision in the terms of the contract is clearly the most important aspect of all commercial transactions. In matters relating to export sales, there is virtually complete freedom of contract. Bodies of legal rules, such as the Uniform Commercial Code which has been adopted by forty-nine states, are designed to provide rules to regulate rights and obligations of the parties to a contract of sale when they do not trouble to specify their respective rights. The matters included in such statutes relating to the rights and obligations of buyers and sellers may be specifically set out by the parties if they choose. However, in domestic sales, it is common to specify only certain terms, leaving other rights and obligations to be determined by reference to the applicable law. This has for so long been the pattern of trade that it is taken for granted and reference is made to the applicable law only when a dispute arises.

By contrast with a domestic contract, an export contract is naturally one which does not necessarily have an obvious and clear connection with any one legal system, such as that of Illinois, Ontario, England and Wales, or West Germany. The parties may not be familiar with each other's law relating to domestic sales and it is particularly important, therefore, to create a private code to cover at least the most important obligations of the seller and buyer. Each type of goods will attract its own special terms, and a list of items to be considered in drafting an export sale contract will be found in standard works of reference.[5]

It is not suggested that export contracts should cover all points set out in the Uniform Commercial Code or similar codes in other countries. Business could not bear the cost of such work no matter how much it would do to achieve certainty in legal relations. It is a question of balancing the business interest in having a short, easily understood

[4] *See* Schmitthoff, *Conflict Avoidance in Practice and Theory*, 21 LAW & CONTEMP. PROB. 429-62 (1956).

[5] *See, e.g.*, ROSENTHAL, TECHNIQUES OF INTERNATIONAL TRADE (1950); PRATT, MODERN INTERNATIONAL COMMERCE (1956).

contract document (whether a special document or constituted by exchange of letters) against the desirability of covering points which may give rise to difficulties if the transaction does not proceed to full performance as hoped and planned.

Some exporters attempt to solve the problem of specifying contractual terms with sufficient thoroughness by tendering to the buyer a standard form contract. This has the advantage that it avoids the necessity of spelling out in a letter or more formal document a multitude of points to cover contingencies which may occur but which the exporter hopes will not. The document may also be drawn to meet the particular needs of the goods which are the subject matter of the contract of sale. For example, a document used by a steel exporter may have special provisions relating to rusting of the goods in transit. A great deal of care and expert advice, legal and other, can be brought to bear on the creation of a standard form contract, the cost of which may be relatively high in relation to one transaction but small when viewed against the number of times the same document will be used. Good draftsmanship is expensive but there is no substitute for it and the task of the expert draftsman is to create a document which, so far as possible, will avoid costly disputes.

Standard form documents have been common in certain commodity trade associations for many years. Mention should also be made of the work being done by the legal division of the United Nations Economic Commission for Europe to create standard form contracts. Several forms have already been worked out to standardize the practices in certain industries and to provide parties to contracts of sale with ready-made documents.[6]

One hazard in the use of standard forms is the danger of causing "a battle of the forms." This may occur when an exporter sends out one form and a buyer accepts on his own form which contains printed terms inconsistent with those on the seller's form, the difference not being noticed in the ordinary course of events because persons using a form will not have time to study the printed conditions in connection with each transaction. This sometimes causes problems in purely domestic transactions and is not peculiar to export sales. On balance,

[6] *See* Cummins, *The General Conditions and Trading Form Contracts of the United Nations Economic Commission For Europe*, 38 N.Y.U.L. REV. 548-74 (1963); Benjamin, *The E.C.E. General Conditions of Sale and Standard Forms*, 1961 J. BUS. LAW 113-31.

the risk of difficulty of this kind is small in relation to the advantages of standard form contracts.

Certain terms, such as "F.O.B.," "C.I.F." and "F.A.S." are commonly used in export contracts and are widely accepted and assumed to be understood. However, courts and trade associations in various countries have interpreted the same trade terms in different ways, and differences in understanding of the same terms by the parties, have lead to difficulties.[7] Standardization is obviously desirable.

One method sometimes employed to specify terms of sale in an effort to avoid conflicts is to incorporate by reference a set of standard terms published elsewhere. Since a contract is basically a creation of the parties to it, they can generally agree to be bound by terms set out elsewhere than in the contractual documents which pass between them. Two sets of standard terms are widely used in modern international commerce: *Incoterms 1953*, prepared by the International Chamber of Commerce, and *Revised American Foreign Trade Definitions 1941*, adopted by a joint committee representing the Chamber of Commerce of the United States, the National Council of American Importers, Inc., and the National Foreign Trade Council. Although both sets of terms are useful to give certainty to the respective obligations of the parties who agree to terms such as F.A.S., F.O.B., C.I.F., etc., they are far from comprehensive and, in our opinion, cannot be a substitute, from the exporter's point of view, for a carefully drawn standard form contract. They do have this attraction: they bear the stamp of approval of important organizations, and buyers who may be reluctant to accept "seller's" terms will probably rest content with the work of an impartial body, such as the International Chamber of Commerce or the joint committee which adopted R.A.F.T.D.

English texts usually define common terms by reference only to English law.[8] American texts used to have to take into account numerous separate jurisdictions, but the laws of these jurisdictions relating to sale contracts have now been made uniform.[9] This may give

[7] *See* THE INTERNATIONAL CHAMBER OF COMMERCE, TRADE TERMS (1953), which contains annotated synoptic tables of the meaning of "ex works," "free on rail (truck)," "free delivered," "F.A.S.," "F.O.B.," "C. and F.," "freight or carriage paid," "ex ship" and "ex quay" in eighteen countries.

[8] *See, e.g.*, SCHMITTHOFF, THE EXPORT TRADE (4th ed. 1962); SASSOON, F.O.B. CONTRACTS (1960); KENNEDY, C.I.F. CONTRACTS (3rd ed. 1959).

[9] UNIFORM COMMERCIAL CODE, particularly article 2.

the false impression that the rules are universal in application and does not take into account the basic question: What is the legal regime of a contract between parties situated in different jurisdictions? Conflicts-of-laws rules do not resolve the problems, because they are merely bodies of law within a system of law which the court within that system will apply when a case involving a foreign element is before it. Although parties may choose a system of law either in negotiation and creation of a contract or in settlement of a dispute (and most systems will recognize and apply a selection made by the parties), it cannot be said that a contract is subject to any particular system until a court, at the instance of a party, has taken jurisdiction over a contract and decided to apply a set of rules, whether its own domestic rules or those of some other system. Even this process will be of little value to a claimant unless the other party or his property can be made subject to a decision of the court which has taken jurisdiction, since, except by coincidence, a law has no application beyond the effective jurisdiction of a nation or legal unit within a nation (such as a state) unless the person sought to be made subject to the law can be controlled or affected.

As a matter of practice, exporters and importers desire that transactions proceed smoothly to full performance and that their relations develop for their mutual benefit. Within this framework, it is meaningful to discuss the definition of some common terms in order to point out how problems might arise. Reference to the elusive nature of the governing-law concept has the important effect of emphasizing the necessity for completeness and precision in creating a contract of sale so as to avoid misunderstanding.

The "C.I.F." term is commonly thought of only as a method of fixing the price, that is, of specifying the obligations which the seller is willing to perform for the quoted price. However, it should be noted that this term has legal implications as well. For example, the passing to the buyer of risk of loss and of title to the goods is usually fixed by this term. In Anglo-American common law, the risk of loss in a C.I.F. sale passes when the goods are "shipped."[10] Title to the goods passes later when the documents are transferred to the buyer.[11] This

[10] *See* INCOTERMS, C.I.F., A-6, p. 36 and B-3, p. 40; *cf.* Seller 6 and 7, Buyer 4, R.A.F.T.D. *See also* SCHMITTHOFF, *supra* note 8, at 31, 69; KENNEDY, *supra* note 8, at 125 and cases there cited; *cf.* UNIFORM COMMERCIAL CODE §§ 2-320, 2-321.

[11] SCHMITTHOFF, *supra* note 8, at 68; KENNEDY, *supra* note 8, at 133.

may be important in the event of insolvency of the buyer or seller and loss or damage not covered by insurance.[12]

Generally, *Incoterms* contains more detail and may therefore be thought preferable, the object of the use of standard terms being to achieve as much certainty as possible. Something will be said later about complications which may result from any attempt by the parties to set out their own terms on points normally covered by the term "C.I.F." while desiring to retain other incidents of the standard C.I.F. sale.

R.A.F.T.D. reflects the several uses of the "F.O.B." term in American practice (*i.e.*, "F.O.B. named inland carrier and named inland point of departure," "F.O.B. named inland carrier at named inland point of departure freight prepaid to named port of exportation," "F.O.B. named inland carrier at named inland point of departure freight allowed to named point," "F.O.B. named inland carrier at named point of exportation," "F.O.B. vessel named port of shipment," "F.O.B. named inland point in country of importation") in contrast to the more restricted usage elsewhere which is indicated by *Incoterms 1953*. F.O.B. *Incoterms* refers only to "free on board a vessel named by the buyer at the port of shipment specified in the contract" and in respect of this definition *Incoterms* is again more specific than R.A.F.T.D.[13]

With regard to the term "F.A.S.," *Incoterms* is also more specific than R.A.F.T.D.[14] Normally the buyer will not have the opportunity to inspect the goods before arrival at their destination. The right to inspect the goods before payment may be stipulated in the contract. Quality certificates may be required, but this is a matter for agreement at the time the contract is made. Difficulties may arise when the parties use trade terms, such as F.O.B., C.I.F. and F.A.S., without spelling out the terms relating to the right of inspection.

The right to inspect the goods before payment will depend on when payment is to be made. Clearly, if a letter of credit is used, the seller is entitled to payment according to its terms. A problem may arise if the buyer is to accept drafts at sight on arrival of the goods. The buyer

[12] *Cf.* UNIFORM COMMERCIAL CODE, art. 2, where a new system is set out.

[13] *Cf.* UNIFORM COMMERCIAL CODE § 2-319.

[14] *See also* Schwind, *F.A.S. Clauses in American and Comparative Law*, 32 N.Y.U.L. REV. 1247-60 (1957). *Cf.* UNIFORM COMMERCIAL CODE § 2-319.

will not normally have the opportunity to inspect the goods before taking delivery of them and he will not get delivery of them until he has paid. Of course, if payment is not required until after delivery, the buyer will have an opportunity to inspect the goods before paying for them.

There is not now any doubt that under a C.I.F. sale (by English law and legal systems adopting English law in this regard, such as Ontario), the buyer is not entitled to inspect the goods before taking up the documents. He must take up the documents tendered in accordance with the contract.[15] Under C.I.F., the buyer has two separate rights of rejection: (1) the right to reject documents not tendered in accordance with the contract and (2) an entirely distinct right to reject goods not in accordance with the contract, notwithstanding prior acceptance of the documents.[16] However, the buyer's position will be difficult if, having already paid for the goods, he is faced with the choice of rejecting the goods and pursuing his claim against the seller who may be thousands of miles away and subject to a legal system strange to the buyer, or taking the goods, realizing as much as possible from them, and pursuing a claim against the seller for the difference.

Rules regarding the buyer's right to inspect and reject goods differ from one legal system to another and are not spelled out in *Incoterms 1953* or *Revised American Foreign Trade Definitions*. Because of the importance of these rights, contracting parties will probably find it convenient to make reference to them in the document evidencing the contract of sale.

C.I.F. has the advantage to the seller that he satisfies his contractual obligation by tendering documents in accordance with the contract, whether the goods arrive or not and regardless of damage in transit.[17] Variation in the standard terms may destroy the C.I.F. nature of the contract.[18] For example, "no arrival no sale" is not consistent with C.I.F. obligations. Other variations that may have the same effect are "insurance for account of sellers," "payment net cash against shipping documents payable on arrival of steamer," "net cash against shipping documents in New York on arrival of goods."

[15] *Cf.* UNIFORM COMMERCIAL CODE § 2-513(3).

[16] Kwei Tek Chao v. The British Traders & Shippers Ltd., [1954] 2 Q.B. 459.

[17] *Supra* note 7.

[18] *See, e.g.*, Comptoir d'Achat et de Vente du Boerenbond Belge S.A. v. Luis de Ridder Limitada, [1949] A.C. 293, R.A.F.T.D., "C. and F." and "C.I.F." Comments, no. 8.

LOCALIZING THE CONTRACT WITH RESPECT TO GOVERNING LAW

Exporters are often advised to stipulate in their contracts that they are subject to the law of the jurisdiction in which the exporter carries on business. This is a simple way to bring the legal aspects of the contract within familiar surroundings. Such a choice of law will generally be given effect by the courts in North America and Western Europe.[19] However, the buyer may be reluctant, or even refuse, to subject the contract to a legal system entirely unfamiliar to him. If his position in the transaction is strong, he may even exact from the seller a term that the contract is to be governed by the law of the buyer's place of business.

Another method of localizing the contract is to stipulate that the courts of a designated jurisdiction (buyer's, seller's or neutral) shall have exclusive jurisdiction in case of dispute. Such a term will be respected by courts in some countries and in some situations, but possibly not in others. For example, in a New York case, the court refused to dismiss an action on the ground that the parties had agreed that the courts of Rotterdam should have exclusive jurisdiction.[20]

ARBITRATION

Persons negotiating an export contract do not wish to risk losing the contract over a failure to agree on such technical points as the governing law when it is the hope and expectation of both parties that the contract will be performed smoothly and without recourse to law. At the same time, the risk of dispute is always present and some provision for resolution of disputes should be included. It is therefore common to provide for arbitration under the rules of an impartial body, such as the International Chamber of Commerce, the American Arbitration Association or the London Court of Arbitration.

An agreement by the parties to submit to an arbitration tribunal constituted in a particular jurisdiction may be taken as an agreement that the contract is to be governed by the laws of that jurisdiction. Thus, stipulation for arbitration in such cases is another method of localizing the contract with respect to governing law.[21] Arbitration is

[19] 2 RABEL, THE CONFLICT OF LAWS: A COMPARATIVE STUDY, ch. 28 (1960).

[20] Chemical Carriers Inc. v. Smit, 154 F. Supp. 886 (S.D.N.Y. 1957); *See also* Takamuran & Co. Ltd. v. The S.S. Tsuneshima Maru, 197 F. Supp. 909 (S.D. New York 1961); RABEL, *supra* note 19, at 382, footnote 89.

[21] RABEL, *supra* note 19, at 387-88.

widely used as a technique for resolving disputes between exporter and importer, but it should be noted that arbitration does not guarantee freedom from legal difficulties.[22]

An award or judgment is small consolation if it is not satisfied by the defaulting party. Enforcement is effective only where the debtor has assets which may be seized. Thus, even if an exporter is succesful in an arbitration, he may be faced with the same problem he would have been faced with if he had taken legal proceedings in the buyer's place of business.

In recent years, American scholars, and English judges in several leading cases, have drawn attention to the fact that going to arbitration under the terms of a trading contract merely resulted in increasing the number of stages of appeal. For example, in several cases an arbitrator's award was appealed to an appeal board within the trade association, then taken to the regular courts which meant, first, high court, then court of appeal and House of Lords.[23] A similar hierarchy of courts exists in Canada. Thus, two additional stages with attendant expense were added. How much simpler and less expensive it would have been to go to the regular courts in the first place.[24]

The English cases in which the remarks critical of arbitration were made involved questions of law. A distinction is usually made between "technical" arbitration, which involves purely legal questions, and "quality" arbitration. It is in connection with the latter that experts in the trade will likely be preferred by the parties and where there usually will not be a matter of law which might be taken to the courts.[25] Even where there is a matter of law to be decided, English and Canadian courts have ruled that if a specific point of law is referred to arbitrators, the parties are usually bound by the award whether or not patently wrong in law.[26] The English cases referred to involved a general reference to arbitration of all disputes which might arise under

[22] *See*, DOMKE, *International Trade Arbitration, 1958 International Chamber of Commerce, Commercial Arbitration and the Law Throughout the World*, in HANDBOOK ON INTERNATIONAL COMMERCIAL ARBITRATION (Sanders ed.).

[23] Ross T. Smyth & Co. Ltd. v. Bailey, [1940] 3 All E.R. 60, 62; Peter Cassidy Seed Co. Ltd. v. Osuustukkukauppa I. L., [1957] 1 All E.R. 484, 489.

[24] Peter Cassidy Seed Co. Ltd. v. Osuustukkukauppa I. L. *supra* note 23.

[25] Mediterranean & E. Export Co. Ltd. v. Fortress Fabrics (Manchester) Ltd., [1948] 2 All E.R. 186.

[26] RUSSELL, ARBITRATION, 316 (17th ed. 1963); Faubert & Watts v. Temagami Mining Co. Ltd., [1960] 22 D.L.R.2d 220.

the contract and in these cases the arbitrator's award is subject to review by the court.

Although numerous cases have been reported in which arbitrator's decisions on points of law have been appealed to the courts with the result that the arbitration proceedings merely added to the number of tribunals in the hierarchy, it would not be advisable to make a distinction in the arbitration clause of a contract between technical and quality arbitration because this would merely add another potential area of dispute: When is a question a "technical" one and when, a "quality" one? Probably the whole matter is best left to be decided by an exporter in the light of the facts of his particular trade. For example, it would be relevant to consider whether competent arbitrators are readily available and whether there is an established custom in the trade.

UNIFICATION OF INTERNATIONAL SALES LAW

A discussion of export sales contracts would not be complete without reference to the work which has been done toward unification on an international basis of law relating to this subject.[27] Two approaches should be distinguished: (1) proposals to make uniform the laws of the different jurisdictions and (2) proposals for agreement on one body of law to govern international sales. Under the former, the rules to be applied to any particular question will be the same whichever law is the governing law; under the latter there is only one body of law, established by international agreement, by which trading contracts are to be governed. Despite much effort over many years, progress has been slow. Perhaps the development of regional economic communities will increase the possibility of progress toward unification of international sales law.

DISTRIBUTION ARRANGEMENTS

Effective penetration of foreign markets usually requires the establishment of a network of distributors in those markets. There is, of course, a variety of possible arrangements. For example, the distributor may be merely a commission representative whether exclusive or not

[27] *See*, Farnsworth, *Formation of International Sales Contracts: Three Attempts at Unification*, 110 U. PA. L. REV. 305 (1962); Honnold, *A Uniform Law for International Sales*, 107 U. PA. L. REV. 299 (1959).

or he may be a distributor who buys and sells on his own account. Such arrangements may merely be a step toward the establishment of a sales branch or subsidiary. The most common arrangement for a company relatively new to exporting is the engagement of local distributors who know the market and who have established relations with dealers or directly with end users. The form selected initially and developed later is basically a matter of business judgment.

Distribution agreements can be formal and complex, or very informal, leaving details to be worked out as business develops. Businessmen dealing for the first time with a foreign distributor will often be reluctant to raise questions in a formal agreement which they fear will frighten away a good distributor. No one wants to dwell on problems which may arise; everyone wants to consider prospects optimistically. Although there may be something to be said for maintaining loose arrangements, as in simple letter agreements, we favor formal agreements. In these, the following points, often overlooked, are important. The date and place of execution of the agreement may be important when determining validity of a contract under civil law. Specifying the exporter's own law as the one to govern interpretation of the contract may solve many problems if a dispute arises. However, this will not prevent the contract's being subject to local laws for the benefit of distributors. Likewise, specifying English as the official language of the contract will be important. Never state that both languages will prevail, as is sometimes done. Very difficult problems of translation can result. Where government approval is required, it should be made the responsibility of the distributor to obtain it and pay any charges connected therewith since there could be import restrictions which are unknown to the exporter. Designation of the currency in which payment is to be made is also important since convertibility may require a license or government approval. The United States prohibitions against trading with communist countries must be kept in mind if there is any chance that domestic goods will find their way into certain communist countries.[28] In distribution contracts, it is important to be

[28] At present, trading with communist countries or nationals is for the most part regulated by three federal statutes: (a) The Trading with the Enemy Act of 1919 as amended and supplemented by; (b) the Foreign Assets Control Regulations and the Transaction Control Regulations; (c) The Mutual Assistance Control Act of 1951. Of these, only the first and the second are directly applicable to the activities of United States entities that they own or control. The third is primarily concerned with shipments to communist areas by nations of friendly powers, uncontrolled by United States

sure that a principal to principal relationship is created and not an agency. In addition to the many unknown and unwanted liabilities that could be created by an agent, there are also foreign labor laws to contend with. In some countries, an agent is an employee and, as such, is entitled to labor benefits, which are not insignificant by any means.

The status of the distributor is particularly important in determining his rights on termination of the contract. In practice, this has probably been the most difficult aspect of distribution arrangements from the point of view of an exporter who is accustomed to being able to terminate a distribution contract without further liability to himself upon giving notice specified in the contract or, in the absence of such agreement, upon reasonable notice.

There are roughly three categories of foreign laws which may be encountered. First, there is the traditional English law which prevails in Canada, England and Australia under which parties to a distribution contract, whether the distributor is buying and selling on his own account or whether he is acting as a mere agent, may agree to any termination provisions that suit them. If the contract provides that a distributorship may be terminated on thirty days notice on either side, that governs the matter and there are no paramount statutory provisions which give greater rights to the distributor. In fact, in the countries mentioned, there is not even the protection accorded to the distributor of being able to require that his supplier buy back inventory on hand although the inventory may be rendered practically useless by termination of the distributorship. A well-drawn distributorship contract, of course, will cover the point expressly.

A second category of countries includes Belgium, France and Puerto Rico which have enacted laws for the protection of agents and distributors. Belgian law, for example, requires that, regardless of express contract provisions to the contrary, a distributor be given "reasonable" notice or "fair" compensation.[29] The law is based on the notion that a distributor becomes dependent on the status accorded him by his supplier and that the foreign principal has benefited from

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interests, and, generally speaking, it provides that United States aid may be cut off in such cases. The basic difference between the first two acts is that the Trading with the Enemy Act is employed primarily to regulate shipments by American firms and their foreign affiliates from abroad, whereas the Export Control Act regulates exportations from the United States.

[29] Law of July 30, 1963, Concerning Sale Contracts; Law of July 27, 1961, Concerning the Termination of Exclusive Sale Concessions.

the distributor's efforts. A short term contract subject to renewal will not avoid the laws if the fact of the matter is that the distributorship has continued on an indefinite basis. In France, dependent agents are entitled to the benefit of labor law principles which provide for substantial notice or indemnification for cancellation.[30] Independent merchant dealers by contrast are not automatically entitled to such protection, but there have been recent cases in which damages have been awarded where the French courts held that the distributorship contract had been terminated too abruptly. In Germany, dependent agents are entitled to the benefit of protective laws, but independent agents may contract out of those laws and the German courts will recognize a contractual clause choosing foreign law in such cases.[31] For example, an Illinois exporter may agree with his German distributor that Illinois law shall govern the rights of the parties and this will usually be given effect by a German court. Whether a distributor is a "dependent agent" or an independent one will depend upon all the relevant facts including whether he must furnish a list of customers to the United States exporter, whether he employs his own capital in the business, whether there is a specified sales territory and the extensiveness of reporting requirements.

A third group of countries employs the labor law approach. This prevails generally in Latin American countries, the principle being that an individual distributor qualifies as an employee. The basic test of whether he does or not is based on an assessment of the dependent or subordinate nature of his position in much the same way as it is under German law. The application of the labor laws can generally be avoided by a United States exporter who deals only with incorporated distributors and not with individuals.[32]

LICENSE AGREEMENTS

We have discussed various aspects of the distribution of American-made goods. Within the framework of our title, we now move to discuss the manner in which United States corporations attempt to penetrate the foreign markets with a manufacturing operation abroad. Many

30 Decree of December 23, 1958, Concerning Agents.

31 GERMAN COMMERCIAL CODE, art. 89b.

32 *See* Meek, *Overseas Distributorship Agreements*, 21 BUS. LAW. 661 (1966).

domestic corporations which have been engaged in a foreign business on an export basis as outlined above desire to expand their international operation to include foreign manufacturing. This may be accomplished in several ways. It must be emphasized at the outset, however, that the approach which is taken by any one United States corporation must be analyzed from the point of view of that company's particular situation. The needs of one corporation in its international operations may be very disimilar from those of another.

One question which often arises is whether it is more advantageous to embark on a licensing program, to manufacture directly in foreign countries, or to enter into joint ventures with local manufacturing companies. Many factors will control this determination. An important factor will be the laws of the host country.

We should deal first with the question of what is sought to be accomplished by foreign manufacture. The trend throughout the world, including our own country, is in the direction of freer trade and lower tariffs. With productive, competitive powers coming into being, as is the case in Europe with the Common Market, the Outer Seven, and Japan on the other side of the world, many foreign-made goods, with their lower costs, have become a factor to be reckoned with in the American domestic market. American producers are thus forced to take advantage of the lower foreign production costs.

Furthermore, if the tariff walls grow higher in various parts of the world, the only means by which United States companies will participate in those markets will be to manufacture abroad. Without such physical penetration, United States concerns will find themselves effectively foreclosed from such markets.

It is no longer the case that domestic sales and manufacture will produce greatness on an international level. With the cost of materials and labor what they are today, few companies can operate on a sufficiently large mark-up to produce excess capital for reinvestment in expanded or better facilities. In fact, many companies have found their profits on domestic sales, even though they may be leaders in their field, so reduced as to necessitate consideration of a curtailment of their domestic activities.

More and more countries have become nationalistic in their political and economic tendencies. These countries have found the means, through governmental agencies, to control to one degree or another, the amount of royalties or technical service fees which are drawn out.

The question, here, however, is not so much whether to manufacture abroad, but how to do so. Should it be through licenses, subsidiaries, or joint ventures.

Our feeling is that license agreements have one serious shortcoming and that is that they do not produce a permanent economic penetration by the licensor into the licensee's country. Generally, the pattern of such agreements is for the licensor to provide the licensee with the right to use patents and trademarks and to provide him with sufficient technical knowledge to enable him to manufacture the product in his country. This involves a substantial expenditure on the part of the licensing company in the initial stages of production and a license fee or royalty is paid in return (maybe!). Generally, the license fees are to be paid long after the technical information and know-how have been imparted to the licensee.

Further, as improvements are made from time to time by the licensee and as he develops skill and experience in use of the technical data and technology imparted by the licensor, he may conclude that he no longer needs the assistance of the licensor or that the value of the original license to him has long since been repaid. The licensee in such cases may look for ways to avoid his obligations under the license agreement or, of course, may just refuse to pay the royalties. Should the latter situation occur, the licensor is left with his bare legal rights, which, in a foreign jurisdiction subject to foreign courts and nationalistic tendencies, may not be of much value.

Even assuming that the licensee continues to pay the royalty, the licensor never really has a permanent interest in the arrangement. Experience has demonstrated that the real effect of licensing is the creation of a competitor. The result is that the licensor is perhaps permanently shut out of markets whose potential could be greater than the domestic market.

Many companies have, of course, found licensing to be a very profitable way of exploiting patents, technical data and technology with a minimum of investment. Assuming that all alternatives have been fully explored and that a decision has been taken to engage in a licensing program, we suggest that the following points be given particular attention in drafting the license contract. Again, we concentrate on the contractual aspects of the relations between the licensor and the licensee within the framework of the title of this paper. Careful planning and drafting are particularly important to avoid, so far as pos-

sible, unpleasant surprises as the licensing arrangement goes into operation.

WHAT DOES A COMPANY HAVE TO LICENSE?

A company may license its patents, technical data which is not incorporated in a patent, technology and trademarks. If a company has attempted to secure patent rights abroad, licensing of the rights will usually be an essential part of any agreement. However, many companies find that it is either impossible or unreasonably expensive to secure effective patent protection at home or abroad, and they prefer to rely instead on their competitive advantage in technical data and technology. By technical data we mean information which may be secret and which has been reduced to blueprints, specifications, manuals, etc. (It may be important for certain tax purposes to distinguish aspects of the licenseable package which will qualify as property from aspects which are in substance services.) By technology we mean what is commonly described as know-how—the accumulated experience of personnel of the United States company. This is probably better described as "show-how," because it really involves the ability to show someone without the experience how to manufacture a product or provide a particular kind of service. Trademarks and trade names may correctly be regarded as a separate species of property. This may or may not be important in a foreign market depending upon whether the trade name or trademark has come to be known to prospective purchasers and whether the United States exporter or licensor desires to develop the goodwill value of the marks or names in particular markets. This is purely a marketing decision and often depends upon the acceptability and impact in a foreign language, of a trademark which is established in the United States and probably in other English-language countries, and which creates the desired impression.

Patents and trademarks usually have statutory protection of the exclusive right to use them. However, the competitive advantage of technical data and technology may for all practical purposes be lost once it has been disclosed. It is very difficult, in practice, to tie down a licensee to prevent his use of technology and technical data for his own benefit after termination of the license agreement or, indeed, in contravention of it.

A decision with regard to the question of whether a mere license is desirable or whether export of technical data and technology should

be coupled from the beginning with participation or active control will depend on particular circumstances. Consideration should include careful assessment of the prospective life of the commercial value of the technical data and technology and the possibility of maintaining its value as well as control over its use by constant development and improvement.

Turning to the details of draftsmanship, we recommend that flowery and expansive recitals or whereas clauses be avoided. Foreign courts may give them much more weight than we are accustomed to. Further, it is essential to define explicitly the rights to be licensed. This may be relatively simple for the unusual case where the right to be licensed is merely a patent, but it is more complicated where technical data constituted by an accumulation of manuals, specifications, etc., is concerned. Particularly difficult is the specification of technology to be licensed and the obilgation of the licensor to provide for inspection of its operations and instruction of licensee's personnel without disruption of its own plant. Licensors commonly undertake to supply personnel to licensees for periodic visits. Questions of how often, how long, who pays, how much, and whether the expenses are to be covered by the license fee, should be explicitly covered. It is very important to avoid such general obligation clauses as, "Licensor will take all steps necessary to assist licensee in the use of the property hereby licensed." Demands which the licensee regards as reasonable may well impose an unmanageable drain on licensor's personnel and resources.

COMPENSATION

A disclosure fee is not uncommon to compensate the licensor for initial expenses and to discourage triflers. At the same time, it gives the licensor some compensation and protection against the possibility that the licensee will become insolvent and unable to meet its obligations under the license.

The simplest form of periodic compensation consists of a specified percentage of net sales of products manufactured through the use of the licensed property or to which the licensed trademarks are applied. This will normally be a deductible expense for tax purposes to the licensee and ordinary income to the American licensor. It is possible in the latter connection to create a "capital gains" license under which the transfer of the property to be licensed qualifies as a sale or exchange for United States tax purposes, with the result that the consideration

is taxed to the American licensor at capital gains rates rather than ordinary income rates.

The essential feature of such a capital gains license is that the transfer of property must be exclusive and perpetual, subject only to reverter for failure to work or insolvency of the licensee and other similar conditions. The installment payment for the sale of the property can be a percentage of net sales on an indefinite basis. Special considerations apply where the licensee is a subsidiary, or a joint venture in which the licensor is participating, and these have to be carefully considered. Further, the tax law of the licensee's country must be considered to be sure that payments are not capital payments from that point of view which would render them other than a deductible expense to the licensee. For example, under Canadian and English law, the purchase of property for use in the business will not be a deductible expense if the property is regarded as a capital asset. Capital gains licenses require careful planning and attention to detatil. Such detail is beyond the scope of this article.[33]

SUB-LICENSES

The prohibition or restriction of sub-licenses or assignments will often have antitrust implications, both domestic and foreign. In any case, it is essential to make sure that the basic license agreement provides adequate compensation if sub-licensing or assignment is permitted. Sub-licensing and/or assignment can often be effectively discouraged by stipulating for a particularly high rate of return.

DURATION AND TERMINATION

The licensee will ordinarily want assurance of a long-term right to exploit his investment. The licensor, on the other hand, usually wants to limit the duration of the agreement to preserve his own freedom to enter the market more directly than through a license. Again, a licensor's long-range plans must be carefully considered in order to prevent their being frustrated by obligations under a license agreement.

Apart from the normal duration of the license, it is customary to provide for automatic termination on the insolvency of the licensee,

[33] Creed and Bangs, *Know-How "Licensing and Capital Gains,"* 4 P.T. & C.J. OF RESEARCH AND EDUCATION 93 (1960); Cooper, *Tax Aspects of Corporate Exploitation of Invention and Know-How*, 38 SO. CAL. L. REV. 206 (1965).

failure to maintain a minimum royalty, and breach of other terms of the agreement.

IMPROVEMENTS

The respective rights of the parties should be carefully delineated with regard to future improvements, both those made by the licensee as well as those generated by the licensor. Particularly, the right to patent improvements, the free use of them by both parties during the license period (if that is desired, or in the alternative, those terms under which they may be used) and the use of improvements after termination of the license should be covered.

SECRET INFORMATION

Although, practically speaking, secrecy agreements may be difficult to enforce, it is desirable in most instances to write into a license agreement an obligation to protect secret information, and to require a licensee to exact written secrecy undertakings from key employees, sub-contractors, and sub-licensees. The existence of a written secrecy agreement may have value in some cases, and it does draw to the attention of employees the importance of the information, a point which might otherwise be overlooked.

TRADEMARKS

The agreement covering use of trademarks need not be part of the license agreement itself, and it is regarded as good practice to separate them. The protection of trademarks does involve certain special considerations, and it is, therefore, convenient and advisable to have these covered in an agreement which deals only with the marks. Further, in some countries, the trademark license agreement may have to be registered as a registered user agreement and it is, of course, desirable to minimize the amount of information which may be exposed on a public register. In licensing marks, it is particularly important to limit the use of the mark to prevent dilution by allowing it to be used in conjunction with licensee's own marks. For this purpose, it is common to require prior approval by licensor of name plates incorporating the mark, as well as advertising and other written materials.

JOINT VENTURE AGREEMENTS

A wholly-owned subsidiary operation in a foreign country is the simplest way to establish a more permanent economic interest in the

foreign market. If such an operation is not feasible because of capital requirements or other reasons, a company may consider alternatives. As one such alternative, consideration should be given to a joint venture. Under this scheme, the United States corporation obtains an equity interest in the jointly-owned company, and, it is hoped, the equity will grow with the growth of the business. This equity interest may be purchased, or very often, it may be obtained for machinery or know-how transferred to the new company.

A myriad of considerations govern a decision on the desirability of a joint venture. Generally speaking, foreign countries may be divided into those which require some sort of local participation, such as Japan, India and Mexico, and those which do not, such as Canada. Even in the latter case, there is certain discriminatory legislation which favors companies with a degree of local participation. Basic considerations in all countries include resolution of the question of whether it should be a fifty-fifty partnership or whether the United States venturer will take a majority position with attendant control or a minority position only. In all cases, the pre-organization agreement which constitutes a contract among the shareholders will be the most important step.

The following are a few of the points which should be given special attention. The subscription for share capital should be made an enforceable agreement among all parties. Consideration for shares may be know-how and other property to be supplied by the United States venturer, or it may be cash, or a combination. It is usually desirable to restrict the transfer of shares. A first right of refusal is often provided for, although valuation of shares may be difficult. It is essential that the American company be adequately represented in the management of the joint venture company and that certain important matters require shareholder approval. It may be possible to fix the requirement so as to insure a veto by the minority, if desired. The dividend policy should be spelled out, as should the right of a party to cause liquidation of the company. Obtaining government consents should be an obligation of the foreign co-adventurer. It should also be made clear that, on liquidation, all property contributed by the American company will be returned to it and secret information will not be used by the foreign co-adventurer.

In order to put the joint venture in full perspective, we shall review some of the corporate forms that are available in foreign countries, keeping in mind that these are corporate, not partnership forms. The

purpose of the review is to indicate some of the salient features of the available corporate forms. The countries discussed have been selected because of their popularity in recent years with United States enterprises expanding into foreign markets.

GREAT BRITAIN

There are in Great Britain basically two kinds of limited liability companies, limited by shares: the private company and the public company. The private company roughly corresponds to a closely-held corporation in the United States, but, unlike the position in most American states where a closely held corporation is not statutorily defined, a private company is specifically defined in the Companies Act, 1948, as a company which limits the number of its members to fifty, prohibits any invitation to the public to subscribe for shares or debentures of the company and restricts the right to transfer its shares. The last requirement can be met by simply giving the directors a discretion to refuse to register any share transfer. A private company is not exempt from filing its accounts.

A public company is not defined in the Companies Act, but by a process of elimination it is any company which is not a private company. The shares of a public company are not necessarily quoted on a stock exchange.

There is still a special kind of private company, an exempt private company, which does not have to file its accounts. However, it is impossible for a subsidiary of an American company to qualify as an exempt private company, and there is now before Parliament a Companies Bill which will abolish the status of an exempt private company.

In the majority of cases, a private company will be chosen for a joint venture for the following reasons. A private company need have only two shareholders (a public company needs seven), and it need have only one director and a secretary, or two directors one of whom is also the secretary. A private company is cheaper and easier to form, requires fewer formalities and can commence business as soon as it is incorporated.

The flexibility of company law is particularly useful in the case of a joint venture company. Where control is shared fifty-fifty, the articles can be drafted so that absolute unanimity is required before anything can be resolved, the chairman of the board being denied his usual

casting vote. Alternatively, a veto or an overriding vote on certain matters can be given to one or the other of the parties. If control is not held fifty-fifty, there is virtually unlimited power to draft the articles so as to divorce the voting rights and the dividend rights from the capital invested, either by the use of different classes of shares, subdivision of a class of shares or specific reference to a named shareholder. In fact, in these circumstances, drafting the articles is very much like drafting a contract, with the significant advantage from a minority shareholder's point of view, that if his rights are entrenched under the articles, anyone dealing with the majority shareholder or dealing with the company will be deemed to have notice of the minority shareholder's rights and, therefore, cannot be a bona fide purchaser without notice of them.

BELGIUM

The only Belgian corporate entity suitable for foreign-controlled operations is the *Société Anonyme* (*S.A.*), a limited liability stock company. Other corporate vehicles exist under the Belgian law, including the *Société des Personnes à Responsabilité Limitée* (*S.P.R.L.*), and several forms approaching the common law partnership, but these are undesirable. A jural entity may not be a stockholder in the *S.P.R.L.* Further, they are designed to accommodate personal joint ventures where the credit and individuality of the associates is an important consideration and, accordingly, there are usually numerous restrictions on the alienation of the shares in an *S.P.R.L.* Belgian commercial law makes no distinction between the privately-held company and the public company, that is to say, a company whose shares are regularly quoted in the public stock exchange of the country. The latter, however, are subject to the control and surveillance of the Banking Commission, and must have an officially approved auditor examine their books annually.

An *S.A.* must have share capital which must be fully subscribed for upon incorporation, but the law does not prescribe a minimum capital. Twenty percent of each share must be paid in upon incorporation. There must be three directors, but they need not be shareholders or residents or citizens of Belgium. Approved balance sheets and the profit and loss statement must be published in the *Annexes* to the *Belgian State Gazette*.

FRANCE

There are only two types of companies which are considered for the purpose of manufacturing and selling in France. These two companies are called *Société Anonyme (S.A.) and Société à Responsabilité Limitée (S.A.R.L.)* respectively. The *Société Anonyme* corresponds closely to an American corporation, whereas the *S.A.R.L.* has many features which resemble a limited partnership. In our opinion, the *S.A.* is the more suitable form for the foreign controlled corporation in France.

Under French law, the concept of a corporation wholly-owned by one shareholder is not recognized. An *S.A.* must have a minimum of seven bona fide shareholders. In order to comply with this requirement, the necessary number of shareholders in addition to the parent company are normally selected from the officers and directors of the parent company. Each will hold a few shares, and it is preferable that each shareholder execute a binding option in favor of the United States parent.

An *S.A.* not publicly held must have a minimum capital of twenty thousand dollars. The entire capital must be subscribed for and one-fourth of every share must be paid in. The transfer of shares may be restricted, and disproportionate voting is permitted in certain circumstances. An *S.A.* may be managed by a board of directors, which may include a company. There is no nationality or residence requirement. The board of directors is headed by a president who has wide powers. Alternatively, an *S.A.* may be managed by a directorate and supervisory board. French exchange regulations require particular attention. The French authorities appear reluctant to authorize an investment giving a foreign company control of a French enterprise.

GERMANY

The German law permits two basic corporate forms: the *Aktiengesellschaft (A.G.)*, or corporation proper, and the *Gesellschaft mit beschrankter Haftung (G.m.b.H.)*, a limited company. Both corporate forms are judicial entities and both are taxable as such.

Capital stock in the *A.G.* is divided into shares with a definite par value, whereas, the *G.m.b.H.* capital stock is divided into business interests in proportion to the original contributions.

If the *G.m.b.H.* employs less than five hundred persons, it need not have a board of directors, but the *A.G.* form of company requires a

board of supervision of management, with compulsory labor representation on the board. The *G.m.b.H.* may also have compulsory labor representation, but only if the company has more than five hundred employees. Numerous minority rights are held under the *A.G.*, but only a few under a *G.m.b.H.* form of limited liability company.

The *A.G.* requires that the shareholders exercise their rights only by voting and participating in shareholders' meetings, which meetings must be fixed in the articles of incorporation or must be at the corporation's domicile and must be in Germany. The *G.m.b.H.* is more liberal in that the quotaholders may consent in writing to company matters without holding a meeting. Further, when the quotaholders' meetings are held, they may be anywhere, even outside of Germany.

ITALY

The Italian Civil Code provides for five types of associations by means of which business may be conducted, but there are only two suitable for foreign-controlled companies. They are the *Societa a responsabilita limitata*, or the limited liability company, commonly known as the *S.r.l.*, and the *Societa per Azioni*, a corporation proper, generally spoken of as the *S.p.A.*

The *S.r.l.* must have a minimum capital of at least fifty thousand lira (eighty dollars) which must be divided into quotas having a minimum par value of one thousand lira each. A quotaholder's liability is limited to the amount, if any, unpaid on his quota. This form of incorporation is generally used by closely-held companies having limited capital.

The *S.p.A.* must have a minimum subscribed capital of approximately 1,613 dollars (one million lira). The liability of a stockholder in an *S.p.A.* is limited to the amount, if any, unpaid on his shares. The *S.p.A.* is generally the most suitable form of corporation for large enterprises in Italy.

Of the types of business associations which might be used for Italian investment, only in the case of the *S.p.A.* and the *S.r.l.* is the liability of the shareholders limited. There may be some advantages in forming an *S.r.l.* if a company is to have a capital of less than one million lira, since there is then no necessity to have a board of statutory auditors, but, if the company is to have capital of more than the one million lira, there will be no advantage at all in choosing the *S.r.l.* form. In fact, the *S.r.l.* form, being primarily designed as a vehicle for small

enterprises, imposes certain limitations on the transfer of quotas and upon management, and gives rights to individual quotaholders, which may be considered disadvantageous for a large enterprise. Thus, most large business enterprises in Italy take the form of an *S.p.A.*

THE NETHERLANDS

The only Dutch corporate entity suitable for foreign controlled operations is the "*Naamloze Vennootschap*" or "*N.V.*" Dutch corporate law makes no distinction between so-called public and private limited liability companies; the *N.V.* is used as well for enterprises which are publicly-held as for enterprises which are closely-held or family-owned.

Two persons, either jural or natural, are required for the incorporation of an *N.V.* One of these persons can take one qualifying share, which, after the incorporation, can be transferred either to the other incorporator or to the *N.V.* itself.

The name of the company must be in the Dutch language but family names are acceptable, provided that one or more persons bearing the name in question is still active in the business. In the case of subsidiary companies, the name of the parent is acceptable with the addition of "Nederland," "Holland," or "Europa."

Once the articles of incorporation have been executed before a notary, they must be submitted to the Ministry of Justice. If the latter finds that the articles comply with all legal requirements, it will issue a certificate of no objection.

The Code of Commerce makes a distinction between the authorized capital which must be divided into a number of shares, each of a fixed amount of Dutch currency, and the issued or paid-in capital. The authorized capital can be modified by means of an amendment to the articles of incorporation. Unless provided by the articles, no director or board of directors need by appointed, and the company can be managed directly by the managers, who are directly appointed by and responsible to the shareholders. No auditors need be appointed.

SPAIN

Unless it is foreseen that the Spanish controlled operations will require a relatively small capital (less than $83,300) in which case a limited liability company, *Sociedad de Responsabilidad Limitada* (*S.R.L.*), could be used, the only type of Spanish business organization

which can meet the needs of a foreign investor is the *Sociedad Anónima* or corporation (*S.A.*). Three incorporators are necessary for an *S.A.*; two for an *S.R.L.*

Although no nationality requirements are established under the corporate law, it might be impossible for a non-Spanish or foreign investor to establish a wholly-owned subsidiary in Spain due to the effect of the foreign investment laws and much depends on the type of transactions in which the new company will engage. The general rule is that a non-Spanish investor can hold only up to fifty percent of the stock of a Spanish company. However, many exceptions exist to this general rule, and it is always advisable to check whether the proposed type of activities will fall under any of these exceptions.

Although the *S.R.L.* is the type of company specially provided for to suit a closely-held organization, the articles of incorporation of an *S.A.* can be so established to fit either a closely-held corporation or a publicly-held corporation. The incorporation procedures are different depending on whether the corporation (*S.A.*) will be a closely-held or it is to become a publicly-held company.

Under Spanish law the distinction between authorized and subscribed or issued capital does not exist in the same manner as in the U.S. As a general rule, all the authorized capital of the company must be subscribed for and issued upon incorporation of the company. In addition, in the case of an *S.R.L.*, all the subscribed or issued capital must be paid in upon incorporation; in the case of an *S.A.* at least one quarter of the authorized and subscribed capital must be paid in.

Although the incorporators enjoy great freedom in drafting the articles of incorporation to fit their needs and requirements, certain provisions of the corporate law establish some limitations on this freedom. These restrictions sometimes purport to protect the right of the minority shareholders while other provisions try to provide for the continued operation of the company and therefore it is not advisable to require a unanimous vote or other highly qualified majority which might be deemed by the courts to run counter to the provisions of the law. Compared to the United States corporation laws, it can be said that, although the Spanish corporation law is not as liberal as some of the most liberal corporation laws of the United States, it is certainly not as restrictive as some of the most conservative.

Unless the articles authorize the board to increase the capital within a stated period not over five years, each increase of capital requires an

amendment of the articles of incorporation. Under the corporation law any meeting of shareholders called for the amendment of the articles of incorporation requires that at least a specified number of shareholders (normally more than fifty percent of the capital) be present at the meeting and also the resolution must be passed by a qualified majority. Upon incorporation a so-called transfer tax, generally at the rate of 2.7 percent of the authorized capital, must be paid.

MEXICO

Under Mexican law there are two types of business entities which are similar to the United States corporation. One, the limited liability company, *Sociedad de Responsabilidad Limitada* (*S.deR.L.*), could be likened to a closely held corporation; in fact, this type of organization was created to fit the same needs as a closely held corporation. In addition, there is the *Sociedad Anónima* or *S.A.* Under the influence of United States law, and different from many civil law countries, two types of *S.A.* are possible under Mexican law. One is the pure *S.A.*, in which case the authorized capital must be fully subscribed upon incorporation of the company. If an increase of capital is required, a special meeting of shareholders must be arranged and the articles of incorporation must be amended. On the other hand, if a *Sociedad Anónima de Capital Variable* or *S.A. de C.V.* is established, the authorized capital may be increased upon complying with the formalities already established in the articles of incorporation but without requiring a special meeting of shareholders.

A Mexican corporation must have a minimum capital of 25,000 pesos (two thousand dollars) and at least twenty percent of the subscribed capital must be paid in at the time of incorporation. At least five incorporators are required, and, in addition, five shareholders must be listed at all times for an *S.A.* to exist. If the number of shareholders decreases to less than five, a court may decree the dissolution of the *S.A.* Whenever foreigners are to be incorporators or shareholders of a Mexican company, an authorization from the Ministry of Foreign Relations will be required before the corporation can be established.

The articles of incorporation will normally establish the number of and the structure of the board of directors. In addition, a manager or managers may be appointed, but they need not be directors. Furthermore, one or more examiners (*comisarios*) must be appointed by the shareholders to supervise the books and accounts of the company and

report to the shareholders' meeting. Any minority shareholder or group of shareholders representing at least twenty-five percent of the capital of the company is entitled to appoint one examiner.

AUSTRALIA

Australian companies limited by shares are either public companies or proprietary companies. A public company is any company other than a proprietary company, and is, in essence, a company in which the public is or may become substantially interested. A proprietary company is one which provides a constitution (memorandum or articles of association), restricts the right to transfer its shares, limits the number of its members (exclusive of present and former employee-members of the company or a subsidiary) to fifty, and prohibits invitations to the public to subscribe for its shares or debentures or to deposit money with it.

Nearly all foreign companies investing in Australia commence by organizing proprietary companies, because such companies are somewhat easier to organize and operate. For example, a proprietary company need have only one director and two shareholders as opposed to a public company's three directors and five shareholders. Further, a proprietary company can commence business immediately after incorporation without certifying that the minimum necessary capital has been paid-in, without holding a statutory meeting, and without filing a statement in lieu of a prospectus. In the event that management decides that it is desirable to offer part of the equity in the Australian company to the Australian public, then it is a simple matter to change the proprietary company into a public company. This is done by means of a special stockholders' resolution which is filed with the Registrar of Companies.

All companies limited by shares must have the word "Limited" or "Ltd." at the end of their names. Further, a proprietary company must also have the word "Proprietary" or "Pty." as part of its name. The name of the proposed company must not be so similar to that of an existing company that it might cause confusion in the minds of the public. Each Australian state has its own Companies Act (now substantially uniform) and registration is effected on a state-by-state basis. It is thus necessary to ascertain the availability of the name in the state of incorporation and in all other states in which the company will wish to carry on business.

CONCLUSION

Organization for foreign operations becomes more complex as time goes on. However, the experience of United States companies and their professional advisers has also grown to keep pace with foreign and international developments, as well as with developing and expanding United States laws. Many companies know that the complexities of foreign operations do not outweigh the advantages of exploiting overseas markets in one or more of the ways described in this article. Each day the number of companies operating abroad increases. We hope that this article may prove of assistance to those considering venturing abroad for the first time, or expanding their activity outside the United States.