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Managing U.S. Litigation Risk: Essentials for the Foreign Company

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Why Foreign Businesses Need to Understand U.S. Litigation

- Many factors – globalization, heavier international trade, the Internet – bring foreign companies into more frequent contact with U.S. markets and companies than ever before.

- Based on those contacts, and sometimes just on corporate relationships with U.S.-based entities, U.S. courts will extend jurisdiction to foreign companies.

- Ergo, be prepared: *With advance planning and understanding of those elements, litigation risk can be controlled and mitigated.* Although the litigation process in the U.S. differs substantially from that of most other countries, there are predictable elements.

Some Myths About the U.S. Court System

- That foreign parties face disadvantageous bias.
  - In cases between U.S. and non-U.S. parties decided in U.S. federal courts between 1986 and 1994, foreign parties won 80% of the cases that they filed as plaintiffs, whereas the overall win
  - rate for all plaintiffs was only 64%. When U.S. plaintiffs sued non-U.S. defendants, the plaintiff win rate fell to 50%.
  - Thus, foreign plaintiffs fared better than U.S. plaintiffs, and foreign defendants fared better than U.S. defendants.
- That every case languishes, taking inordinately long to resolve.
  - Of 284,489 pending cases in 2010, only 15.8% were pending more than three years. The majority, 56%, were pending less than one year.
    (Federal Judicial Center 2010 Analysis.)

Further Myths About the U.S. Court System

- That every case goes to trial or is heard by a jury.
  - In fact, there are multiple means by which U.S. courts can and do winnow meritless cases out before trial.
  - Case law following *Ashcroft v. Iqbal*, 129 S. Ct. 937 (2009), facilitates resolving case at initial or pleading stage.
  - Following a trilogy of landmark U.S. Supreme Court cases decided in 1986, summary judgment procedure has emerged as "the new fulcrum of civil dispute resolution." Percentage of civil cases proceeding to trial in federal courts dropped from 8.5% of all pending cases in 1973 to around 1.8% today.
  - The vast majority of cases are resolved by settlement.
- That every jury is a "runaway" jury.
- That punitive damages commonly awarded.
- That discovery is completely unconstrained.

Goals of This Program

- To correct these myths and update some of the conventional wisdom that shapes the foreign company's decision-making.
- To reduce uncertainty about how U.S. litigation may arise and about how it impacts the foreign company.
- To enhance understanding of how U.S. courts exercise jurisdiction over foreign companies, and to learn specific means to reduce that exposure.
- To understand in what ways the foreign company can exercise control, in advance, over various aspects of U.S. litigation.

Controlling Risk: The Contracting Process

- Commercial relationships, for example, with U.S. customers, vendors, and distributors, can be controlled more easily than consumer relationships, known or unknown.
- Comprehensive, American-style contracts are the most powerful defense in the foreign company's risk-avoidance arsenal.
- Implement Standard Terms and Conditions, including:
  - Choice of Forum (picking the court in advance, or including carefully drafted arbitration clause)
  - Choice of Law
  - Required mediation / good faith conferral
  - Waiver of jury trial (depending on jurisdiction)
  - Limitation of remedies (limiting consequential damages, including lost profits, and punitive damages)
  - Indemnification provision for suits arising from activity of counter-party
  - No written modification of contract
  - Allocation of Attorney's Fees in dispute

Structuring the Contracting Process to Minimize Risk

1. Centralize final review of any contracts in the company.
2. Make clear to counter-party that discussions not final until final approval secured.
3. If Terms and Conditions are referenced in contract, make sure they are available (website) or supplied to the other party.
4. Resolve the “Battle of the Forms,” noting and addressing competing provisions in the other party’s terms and conditions.
5. Decide whether CISG (Convention on Contracts for the International Sale of Goods) should apply. If not, must include an explicit opt-out in the contract.
6. For ongoing business, consider a Master Agreement with controlling terms, under which individual purchase orders or statements of work will issue.

Protecting Foreign Parent Corporations from U.S. Jurisdiction

- Plaintiffs often seek to disregard the corporate form of U.S. subsidiary to hold non-U.S. parent company directly liable (known as piercing the corporate veil).
- Plaintiff goals in filing lawsuit against subsidiary and its non-U.S. parent:
  - Reach a "deep pocket;"
  - Increase settlement value;
  - Obtain broad discovery of the parent corporation (itself an incentive for defendants to settle).
- Personal jurisdiction over non-residents focuses on whether it is:
  - authorized by a state “long-arm” statute; and
  - consistent with Constitutional due process requirements.
- General jurisdiction -- defendant may be sued in the forum for conduct anywhere in the world.
- Specific jurisdiction -- relates to a defendant's specific contacts with the state that gave rise to the lawsuit.

General Jurisdiction: More Difficult for Plaintiff to Establish

- More difficult to establish than specific jurisdiction. Based on “continuous and systematic” business contacts with the forum.

- Discussed by Supreme Court most recently in *Goodyear Dunlop Tires Operations, S.A. et al. v. Brown*, 131 S. Ct. 2846 (2011).

- Determining no general jurisdiction existed over foreign manufacturing affiliates, *Goodyear* observed that affiliates were not registered to do business in NC, had no place of business, employees, or bank accounts in NC, do not “design, manufacture, or advertise” products in NC, and do not solicit business in NC or themselves ship or sell tires to NC customers.

Specific Jurisdiction: *J. McIntyre Machinery, Ltd. v. Nicastro*

- In a 2011 decision, *J. McIntyre Machinery, Ltd. v. Nicastro*, 131 S. Ct. 2780 (2011), the U.S. Supreme Court held that a U.K. defendant whose product was distributed throughout the U.S. and ended up in New Jersey (NJ), where it caused injury, was not subject to jurisdiction in NJ.
- Plaintiff relied on three facts to support jurisdiction:
  - U.K. company utilized independent distributor in Ohio to sell product in the U.S.;
  - U.K. company attended annual conventions in the U.S. – but not NJ -- to advertise its products; and
  - Between one and four of defendant's machines ended up in NJ.
- Plurality opinion – merely placing a product in the stream of commerce, even where it "might" end up in NJ, is insufficient to establish specific jurisdiction.
  - A defendant's distribution of its product "permits the exercise of jurisdiction only where the defendant can be said to have targeted the forum."

Nicastro's Analysis

- Majority of justices repudiated the "foreseeability" approach to determining whether specific jurisdiction is appropriate.
  - "Foreseeability" approach followed by four justices in *Asahi Metal Industry Co. v. Superior Court of Cal., Solano Cty.,* 480 U.S. 102 (1987), and subsequently adopted by some federal circuit courts.
  - Under the "foreseeability" approach, a foreign company's placement of its product into the "stream of commerce" could serve as a sufficient basis for an exercise of specific jurisdiction by a particular state, so long as the company could have foreseen that its product would end up in that state.
- Significance of *Nicastro* -- Court signaled that a foreign company can avoid a state's specific jurisdiction, even though the injury to the plaintiff occurred within the state.

Sales Strategies Following *Nicastro*

- Under the rationale of the plurality in *Nicastro*, a foreign manufacturer could protect itself by conducting all U.S. sales through an independent nationwide distributor, or perhaps even a subsidiary, as long as the sub acts independently and its distribution strategy is not controlled by the foreign parent.
- The foreign company can still target the overall U.S. market and even participate in its distributor's general marketing effort, provided that such effort does not target specifically any individual state.
- But the concurrence in *Nicastro* expressly left open a number of questions, such as whether substantial sales to a particular state create the requisite jurisdictional nexus, even absent direct targeting.
- Justices Breyer and Alito reserved the question of whether a foreign company's direct Internet-based marketing of its products to US consumers could lead to an inference that the company knew the advertisements would be viewed by consumers in a particular state.

Sales Strategies Following *Nicastro*

Nicastro suggests that the following actions might minimize a foreign company's litigation exposure, if not necessarily guaranteeing immunity from claims:

- using an independent nationwide distributor for all of the company's U.S. sales;
- avoiding business activity that targets or concentrates on a particular state;
- focusing the company's marketing effort on nationwide U.S. marketing, avoiding any "special state-related design, advertising, advice, marketing, or anything else" for its products destined for the U.S.; and
- considering carefully any marketing or sales activities connected to states whose courts are notoriously unfavorable for tort defendants.

Websites & Jurisdiction

- U.S. courts generally characterize Internet use as falling within three categories, operating on a sliding scale, for the purposes of establishing personal jurisdiction:
  - websites clearly used for transacting business over the Internet, such as entering into contracts and repeated transmission of files of information, which suffice to establish minimum contacts;
  - interactive websites, which allow the exchange of information between a potential customer and the host computer, and which may establish minimum contacts depending on their degree of interactivity; and
  - passive websites used only for advertising or posting information which have been found to be insufficient to establish minimum contacts unless their use is coupled with additional business activity in the forum.

Is Simply Owning The Subsidiary, With No Direct Parent Contacts with the U.S. State Forum, A Basis for Jurisdiction?

- *Not necessarily*…will likely not be the only basis a plaintiff asserts for establishing jurisdiction.
- Merely owning an in-state subsidiary's stock is rarely sufficient to establish personal jurisdiction (whether general or specific) over a foreign parent.
- But, creative plaintiffs will look to another set of theories focusing on the foreign parent-subsidiary or foreign parent-affiliate relationship.

How Plaintiffs Seek to and Can Impute Jurisdiction to Parent

- Even where no specific jurisdiction over foreign parent, plaintiffs may still seek to impute the subsidiary's jurisdictional contacts to the foreign parent.
- Two theories:
  - The subsidiary is the parent's agent:
    - Subsidiary agreed to act as the parent's agent.
    - Parent exercised total control over the subsidiary.
  - The subsidiary is the parent's alter-ego.
    - In *Goodyear*, Plaintiffs alleged, but the Supreme Court did not consider, jurisdictional theory of “single enterprise” with “integrated worldwide efforts to design, manufacture, market and sell” into U.S.
- Plaintiffs must persuade the court that the corporate form should be disregarded because the parent and the subsidiary are not truly separate companies.

Agency: Parent-subsidiary

- An agency relationship between a parent and its subsidiary does not need to be express:
  - May be established by reasonable inferences derived from evidence of the relationship.
  - Courts do not typically find an agency relationship without extraordinary control of the subsidiary by the parent company.

- Common ownership of stock of two or more companies and common management, without additional oversight or control, is generally insufficient to establish an agency relationship.

Agency: Distributor or Sales Representative

- Plaintiffs may claim that distributor or sales representative is “agent” of foreign company.
- To avoid:
  - Do not authorize distributor / sales representative to accept service for foreign company.
  - Permit distributor / representative independence and control. Plaintiffs will point to control by foreign company (for example, over market targeting, pricing, and other business decisions) as evidence of agency.
  - Do not provide written agency authorization; instead, disclaim agency in written contract.
  - Consider indemnification provision for claims that distributor / sales representative conduct should be attributed to foreign company.

Alter Ego: Factors Courts Consider

When determining whether a subsidiary is an alter-ego of its parent, courts consider many factors, including whether the:

- Parent owns all of the stock in the subsidiary.
- Subsidiary is adequately capitalized.
- Corporate formalities are observed.
- Parent and subsidiary share corporate officers and directors.
- Subsidiary has its own offices, employees and bank accounts.
- Parent pays the salaries of the employees of the subsidiary.
- Parent siphons money out of the subsidiary.
- Subsidiary pays formal dividends.
- Subsidiary and parent share administrative services, employees or insurance arrangements without proper, arm's length compensation between them.
- Parent uses the subsidiary's property as its own.
- Subsidiary's function is a mere façade for the parent company.

Managing Risk: Countering Alter Ego or Veil Piercing Theories

- Properly capitalizing and insuring the subsidiary.
  - U.S. courts are less likely to extend jurisdiction over foreign parent if the plaintiff can collect the full amount of a judgment against a properly capitalized U.S. corporation.
- Additional steps to counter agency or alter-ego veil piercing theories include:
  - Complying with corporate formalities.
  - Creating the subsidiary's own bank account.
  - Documenting rationale for the subsidiary's capital structure.
  - Documenting inter-company loans.
  - Maintaining appropriate debt/equity balance.
  - Having the subsidiary hire and pay for its own employees.
  - Creating the subsidiary's own board of directors.

When U.S. Litigation Is Threatened: The Action Plan

1. Provide prompt notice to insurance carrier(s) potentially involved.

2. Involve counsel immediately, before responding to any demand letter from Plaintiff's counsel or apparently lawyer-drafted letter.

3. Keep careful file of litigation related documents, like any Complaint, because service of process may be an issue.

4. Preserve (do not destroy or delete) any documents that may be relevant to the dispute.

Transfer of Legal Action: Post-Litigation Risk Management

- *Forum Non Conveniens* -- even if a court has jurisdiction, it can still transfer the case to a foreign (home) jurisdiction where it would be more convenient to hear the case.
  - Very fact-specific. U.S. courts will:
    - Assess whether alternative forum available.
    - Balance public and private interests, including any unfairness to plaintiff.
- Removal to federal court – where case is filed in a state-level court by a U.S. party against a foreign defendant and case could have originally been filed in federal court.
- Transfer under 28 U.S.C. § 1404: Transfer to another federal court in another district "for the convenience of the parties and witnesses."

U.S. Discovery: Key Areas of Difference

- One of substantial areas of concern for foreign and U.S. businesses alike.
- Broad standard of relevance to the claims in dispute.
- Extends to any documents, including electronically stored information, in a party's possession, custody or control.
- Depending on complexity of the case, can range from four months to more than a year in more complicated cases.
- Significant driver of expense – both collection and processing of party documents and review and analysis of opposing side's documents.
- Can be managed by agreement, but still a process that can be unsettling for the foreign litigant.

Protecting Foreign Affiliates from U.S. Discovery

- As a practical matter, liberal discovery rules and corporate interconnectedness often make it difficult for companies to prevent production of foreign records entirely.
- Under Rule 34(a) of the Federal Rules of Civil Procedure, and most state counterparts, companies must produce during discovery those documents, electronically stored information, or things in their "possession, custody, or control."
- Through a very fact-specific inquiry into the relationship between a company and its foreign affiliates, the foreign records may (or may not) be considered under the "control" of the company and therefore discoverable information.
- Courts have defined "control" as "the legal right to obtain the documents requested upon demand."

Determining “Control”

- The physical location of the records is irrelevant, including whether or not the records are in the territorial jurisdiction.

- Where the corporate party is the parent of a subsidiary possessing the records, “control” will exist if the subsidiary “acts as a direct instrumentality of and in direct cooperation with its parent corporation, and where the properties and affairs of the two [were] . . . inextricably confused as to a particular transaction.”

- In particular, “control” will likely exist if the parent has the power to elect a majority of the board of directors of the subsidiary.

Control – U.S. Subsidiary Sued

When the corporate party is the subsidiary of a parent corporation possessing the records, “control” will generally be found to exist if:

1. alter ego doctrine / veil piercing applies.
2. subsidiary was agent of the parent in transaction at issue.
3. agent-subsidiary could normally secure documents of the principal-parent for its own use.
4. Ordinary course access to parent documents exists.
5. subsidiary markets and services parent’s products in the U.S.

Control – Sister Corporations

When the corporate party is the sister corporation under common control and another sister corporation possesses the records, “control” will exist where:

- the sister corporation was found to be the alter ego of the litigating entity, or
- where the litigating corporation had acted with its sister in effecting the transaction giving rise to suit and is litigating on its behalf.

Factors Comprising Affiliate Control

Specific facts considered by the courts include whether:

- the affiliates are wholly-owned;
- the affiliates have different places of incorporation;
- the affiliates have independent decision-making power over their day-to-day operations;
- the affiliates have separate finances;
- the affiliates have the power to elect a majority of their board of directors;
- the affiliates share corporate directors, officers, and executive and administrative personnel;
- the affiliates operate as a single functional unit in all aspects of the business;
- the affiliates could secure documents that are helpful for use in the litigation;
- the affiliates obtain and use the information in the normal course of their business;
- the information is readily accessible in the normal course of the affiliates' businesses;
- the information is commonly accessible in document storage systems or computer networks; and
- the affiliates' access to the information is necessary to their business.

What Disputes May Be Desirable to Adjudicate in U.S. Courts?

- Infringing conduct occurring here (for example, use of trade name or trade mark, or distribution of counterfeit goods).
- Contract counter-party only based here, or only has substantial assets here.
- Swift emergency relief needed: U.S. courts have broad equitable powers to preserve the status quo pending dispute resolution.
- Where U.S. law, especially more technical areas (for example, U.S. intellectual property), likely to be at issue.
- Where the development of U.S. precedent is desirable.
  Note: in most commercial areas, U.S. case law is well-developed and fairly well predictable with appropriate research.

Alternative: Request Discovery for Use in Foreign Proceeding

- American courts are receptive to assisting foreign courts with necessary documents and testimony.
- This option would permit some benefits of U.S. discovery without opening up the foreign company to full discovery as a party-litigant.
- There are at least three methods:
  - First, a “letter rogatory” transmitted through diplomatic channels.
  - Second, a letter of request under the Hague Evidence Convention.
  - Third, (and most convenient), a U.S. statute, 28 U.S.C. § 1782.

Summary of Risk Avoidance

- Considered and comprehensive American-style contracts with suppliers, customers, and distributors, including risk-management terms.
- Attention to the nature of jurisdictional contacts.
- Appropriate structuring of parent-subsidiary corporate forms, governance and operations.
- Appropriate levels of insurance – product liability, commercial risk, D&O – harmonized with home country coverage.
- Due diligence on contract counter-party in U.S., as well as U.S. customer(s), distributor(s), or sales representative(s).
- Prompt action, in coordination with counsel, upon notice of dispute with U.S. company.

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