SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

走出中国 CHINA OUTBOUND

美国翰宇国际律师事务所
Squire, Sanders & Dempsey L.L.P.
October 2009

www.ssd.com

UNITED STATES

Squire Sanders Represents Affected Dealers in Chrysler Bankruptcy

The US government's foray into restructuring the ailing US automotive industry has been widely reported in the media and represents the most substantial federal intervention in the private business sector since the Great Depression. In Chrysler's case, the government took the unprecedented step of orchestrating a "surgical" Chapter 11 bankruptcy filing with the primary goal of utilizing the provisions of Section 363 of the US Bankruptcy Code to sell substantially all of Chrysler's assets to "New Chrysler" in less than 30 days.

An integral component of the proposed asset sale was the continued "rationalization" – read, reduction – of Chrysler's vast dealership network. This effort – previously dubbed Project Genesis – had been put into motion long before the bankruptcy filing, but had never been completed. As of the bankruptcy filing, Chrysler's dealership network comprised 3,181 dealers employing more than 140,000 people. Of these dealers, 789 were slated to have their franchise and related agreements rejected under Section 365 of the Bankruptcy Code. With the assistance of the National Automobile Dealers Association, a Committee of Chrysler Affected Dealers (the Affected Dealers) was established. Squire Sanders was counsel to the committee, which represented the interests of more than 350 Affected Dealers.

While asset sales and contract rejections are common to virtually every large Chapter 11 case, Chrysler's proposed asset sale and Affected Dealer rejections were unusual in many respects and raised numerous concerns. These included the bankruptcy process being utilized improperly to obtain relief not provided for by the Bankruptcy Code or contemplated by Congress as well as Chrysler's not having a sufficient business justification for not assigning all of its dealer agreements to New Chrysler. Given that there had never before been a bankruptcy of a major automobile manufacturer, some of these concerns raised issues of first impression for the Bankruptcy Court.

For instance, to say that the timeline for the proposed asset sale was on a fast track would be an understatement. Chrysler's emergency motion to approve the sale of its assets was among the first filed in the case and contemplated a sale process that would be completed from start to finish in less than 30 days (a typical Section 363 sale takes 60 to 120 days). The timeline for the sale was mandated by the government's unwillingness both to provide necessary financing during the bankruptcy case and to consummate the transaction unless the asset sale was consummated on this expedited track.

The proposed Affected Dealer rejections were not run of the mill requests to reject executory contracts, either. Chrysler struggled to articulate a

valid business purpose for its requests in light of the evidence, and much of the relief Chrysler requested was squarely contrary to numerous state dealer laws. These laws, enacted in all 50 states, are designed to protect dealers in the event a manufacturer seeks to terminate their franchise agreements. For instance, Chrysler sought to give the Affected Dealers less than 30 days' notice of their termination (typically, dealer laws require 60 to 90 days' notice). Chrysler also did not intend to comply with dealer law requirements to repurchase inventory, spare parts and specialized tooling. In essence, dealers were being given less than 30 days to clear their lots at prices well below cost. Additionally, Chrysler sought to predetermine the priority of any and all claims dealers would be able to assert as a result of the rejections and to prospectively enjoin dealers and states from taking numerous actions that they would otherwise be entitled to take.

Despite the complexity of the issues raised by the proposed asset sale and contract rejections, and the speed at which the process was moving, the Affected Dealers and other parties opposing the sale and/or contract rejections met the daunting challenge of conducting discovery in just four days and preparing for the expedited hearings on these issues. Chrysler produced hundreds of thousands of documents in the days leading up to the asset sale hearing, with the last round of documents being produced less than 12 hours before the start of the asset sale hearing. Depositions of numerous representatives of Chrysler and its advisors, Fiat and other parties were taken in the days leading up to the hearing.

Ultimately, the Court approved the asset sale as the only viable option on the table and held that the rejection of the Affected Dealer agreements was in the best interests of Chrysler's estates and creditors. In doing so, the Court overruled the more than 350 objections filed in opposition to the asset sale (including approximately 12 filed by various state attorneys general joining in the Affected Dealers' arguments) and more than 125 objections filed in opposition to the rejection of the Affected Dealer agreements. In approving the asset sale, the Court found that, given the exigent circumstances, adequate notice of the sale was given and that the sale was not a *sub rosa* plan of reorganization. As for the Affected Dealer rejections, the Court held that the business judgment standard was the applicable standard (and not a higher standard applicable to certain categories of contracts) and was adequately met by Chrysler.

However, the struggle was not without its successes. As a result of the actions of the Affected Dealers and other parties, Chrysler withdrew much of its requested rejection-related relief, including (a) the prospective injunction sought under Section 525 of the Bankruptcy Code against actions by dealers and state governments, (b) the predetermination of the priority of dealer claims that may arise as a result of rejection and (c) the extent of its efforts to

pre-empt state dealer laws as they relate to the effect of rejection.

The facts and circumstances of the Chrysler case were unusual to say the least. Never before has a major automobile manufacturer filed for bankruptcy. Never before has the US government taken such an active role in a bankruptcy proceeding. Never before has a sale of a business of Chrysler's size moved as swiftly. Despite these challenges, however, through their collective efforts, the Affected Dealers achieved a measure of success and continue to pursue other avenues of relief through the political and legislative processes. There is also evidence that dealers in the ongoing General Motors bankruptcy – in which GM has pursued a more even-handed approach toward its dealer network – have benefited from the efforts of the Chrysler Affected Dealers. Indeed, although GM has more than twice as many dealers as Chrysler, only 38 dealers are slated to have their agreements formally rejected by GM (less than 5 percent of those rejected by Chrysler). The remainder of the dealers who have not been chosen as "go forward" dealers have signed wind-down agreements that allow them to operate through October 2010 in order to allow for a more orderly wind-down of their businesses.

– Elliot M. Smith

Managing the CFIUS Hurdle to US Investment

Investments in US entities by non-US firms increasingly are subjected to US government review. This is due in large part to the recently broadened understanding of transactions that involve national security issues as directed in legislation passed by the US Congress and implemented by the US Department of Treasury's Committee on Foreign Investment in the United States (CFIUS). Once generally confined to foreign acquisitions related to the US defense industrial base, CFIUS now considers a broad range of transactions pursuant to its expanded authority under the Foreign Investment and National Security Act of 2007 (FINSA) (Pub. L. No. 110-49) and recent interpretive guidance thereof. Under FINSA, CFIUS review includes any national security impact on US "critical infrastructure" and critical information technology. The move toward including critical infrastructure sectors within the realm of national security review began in earnest after September 11, 2001 and was well-illustrated by the Dubai Ports CFIUS review. The term "critical infrastructure" is now defined by FINSA to include businesses and assets so vital to the United States that their failure "would have a debilitating impact on national security, national economic security, national public health or safety." Sectors specifically identified as critical infrastructure include telecommunications, public health, chemicals and hazardous materials, energy, banking and finance, and others.

For China-based firms, particularly firms with government ties, the prospect of a CFIUS investigation can be a daunting one. This is due in large part to several highly publicized attempted acquisitions by China-based firms that were found to negatively impact US critical infrastructure. Most notable among these were the China National Offshore Oil Corporation's (CNOOC) failed attempt to purchase Unocal in 2005 and the proposed merger between China-based electronics firm Huawei and 3Com in 2008, which was terminated due to the parties' inability to remedy CFIUS concerns. These examples are no doubt discouraging to would-be investors. In many cases, however, upfront planning and forethought in careful selection of targets and tailoring investments with an understanding of likely CFIUS concerns can make the process far more predictable and help parties manage costs and avoid missteps.

CFIUS is an interagency committee chaired by the US Department of Treasury, with membership that includes, among others, the Department of State, Department of Justice, Office of Homeland Security and Department of Defense. It is officially tasked with reviewing transactions that could result in control of a US business by a non-US person (so-called "covered transaction") to determine the effect of such transactions on US national security. "Control" as the term is used here does not only mean majority ownership; a non-US acquisition of a minority stake – particularly a dominant minority stake – can be subject to CFIUS review.

The notification of a proposed transaction to the CFIUS is voluntary but in most cases is recommended. Covered transactions voluntarily notified to the CFIUS enjoy a "safe harbor" from further review, while others risk government intervention, even post-transaction. Whether or not they choose to file a voluntary notification with CFIUS, firms based in China considering a US acquisition are advised to address US national security issues as early as possible in the process. In many cases, careful planning of the structure of proposed transactions can help minimize or address national security considerations. One such consideration is whether a covered transaction could result in control of a US business by a non-US government, its agencies or state-owned enterprises. Such transactions involving non-US governments do not necessarily present national security risks, and there are measures parties can take to address such risks in advance of a CFIUS notification. These include adopting governance structures that provide for a measure of autonomy and ensuring transparency of the investment purpose, arrangements and finances of the acquiring firm. Finally, investors should consider, before a voluntary CFIUS notification, possible mitigation agreements with the US government to deal with national security concerns.

– Christopher H. Skinner

Real Cost Cutting Strategies for Patent Prosecution in Today's Market

Businesses intending to manage the bottom line have been scouring the patent prosecution process for ways to cut costs. Some companies are capping the amount of money lawyers can spend to prosecute their patent applications, while others have abandoned patent applications all together.

Capping spending is one cost-cutting strategy that is penny wise and pound foolish. When corporations cap the amount of money – and therefore time – spent on the prosecution of patent applications, the quality of the patent application could be reduced. When significant budget restrictions affect the patent application's quality, the patent application pendency could be much longer than expected. And as pendency of the patent application continues to increase, the cost of prosecuting the patent application will increase; the short term savings increase the long term cost of prosecuting a patent application.

Businesses would be better served returning to patent prosecution basics. Taking time (and spending money) to draft the patent application is a smart move. Although it costs less to speed through the drafting of the patent application, any savings are often outweighed by issues that crop up later. For example, a hastily drafted patent application might leave an examiner confused; the examiner may not clearly understand and appreciate the scope of the invention. When the scope of the invention is unclear, many objections or rejections could be raised that will frustrate the applicant and delay the allowance of the application. In addition, because of the significant number of objections or rejections, the applicant will be required to spend more time and money to have a lawyer prepare arguments to overcome these issues.

However, this issue can be easily avoided if businesses spend their money wisely – i.e., take time to properly draft the patent application. If businesses are willing to allow their lawyer to invest more time on the preparation of the patent application, the lawyer will be able to draft a better and more coherent patent application, which will clearly convey to the examiner what the invention is directed to, and there will be a reduction in the number of objections and rejections during the prosecution of the patent application. This means the examiner will get to spend more time working on substantive issues and will be more likely to grant an allowance of the patent application. The bottom line is that a more complete patent application will reduce the pendency (and cost) for the prosecution of the patent application, which ultimately makes businesses successful.

Businesses should also take advantage of the Manual of Patent Examining Procedure (MPEP). The MPEP includes a set of guidelines for examining patent applications. For example, the MPEP requires that an examiner issue Office Actions that are complete as to all matters. If this requirement is not met, businesses should

request that the examiner issue another Office Action that is complete. A complete Office Action provides a clear record and gives the lawyer prosecuting the case a better opportunity to rebut the rejections made in the Office Action. However, the only way to determine whether the Office Action is complete is for businesses to provide their counsel with ample time to examine the completeness of the Office Action.

This leads to another technique that businesses can use to reduce prosecution costs in the long term. Businesses should spend more time to prepare a thorough response that addresses each rejection in the Office Action. Many businesses appear to be under the misconception that there is no difference between responses that are prepared in two hours and those prepared in six hours. But the time to prepare a response depends upon the issues (i.e., objections and rejections) raised in the Office Action. If the issues are simple, the response can be prepared rather quickly. However, more complex issues will require more time to prepare the response because a thorough analysis is required to properly address them. This will inevitably reduce the length of prosecution, which automatically cuts the cost of prosecuting the application over the long term. However, when prepared hastily the response will not overcome the rejection and the length of prosecution will increase, thereby creating more expense for the business in the long run. Thus, a more complete response will likely overcome objections and rejections and reduce the cost of prosecution over the pendency of the application.

In some instances, when a case is not progressing, applicants typically take steps as varied as further amending the claims, abandoning the patent application or appealing the case to the Board of Patent Appeals and Interferences (BPAI). But these measures usually mean more expense in the long run through the filing of unnecessary responses or appeals without benefit of a better understanding of the examiner's position. Therefore, another smart move businesses can make is to conduct patent examiner interviews. In a patent examiner interview, the applicant (and/or the applicant's lawyer) has an opportunity to discuss the patent application with the examiner. In such an interview, the applicant will be able to explain the invention and scope of the claims, and provide arguments supporting the patentability of the claims in view of the prior art. The applicant will be able to have a dynamic discussion with the examiner and better understand the examiner's interpretation of the scope of the claims in view of the prior art. Furthermore, the applicant will be able to effectively strategize on obtaining allowance of the patent application more promptly.

The examiner interview provides a means to effectively advance prosecution and better formulate a strategy during the prosecution of the application. For instance, the examiner interview can be helpful even in instances when, based on

the examiner's position, the applicant concludes that it is no longer feasible to advance the prosecution of the pending patent application in front of the examiner. When this happens, the applicant can then file an appeal to the BPAI. This step means the applicant avoids spending time and money filing an unnecessary response to the Office Action that more than likely will not advance prosecution, given the examiners' previously stated positions. In those instances, the applicant has now spent less time and money in prosecuting the patent application than they otherwise would have had they continued to unsuccessfully argue with the examiner.

Simple measures – such as completing patent applications, determining whether Office Action is complete, filing thorough responses or even conducting examiner interviews – can have a profound impact on a company's bottom line by reducing the time spent obtaining a patent.

– *Sheetal S. Patel*

ARGENTINA

Argentina Extends Grace Period for Registering Employees

Argentina's government has extended the grace period during which employers in Argentina may comply with employee registration requirements without being subject to fines and sanctions normally associated with late or deficient registration. Pursuant to Decree No. 1018/09 issued on July 31, 2009, the term of the exemptions provided by Law No. 26.476 was extended from July 31, 2009 to December 31, 2009.

Under Argentine law, every employer is required to register its employees with Argentina's Tax Bureau and pay certain social contributions. To encourage the registration of unregistered employment relationships and the correction of deficient registrations (i.e., those registrations in which the employer misreports the employee's wages or the date that the employee was hired), Argentina's Congress issued Law No. 26.476 on December 24, 2008. This law created a grace period during which employers were exempt from the fines and sanctions that normally would accompany employment relationships that were unregistered or deficiently registered. This grace period originally ended on July 31, 2009.

Law No. 26.476 further exempts employers from payment of principal and interest owed on unpaid social contributions for up to 10 employees registered pursuant to the law. However, the exemption from backpayment of unpaid social contributions does not apply beyond the 10th employee registered under the law.

The Extension Decree extended the grace period under Law No. 26.476 from July 31, 2009 to December 31, 2009 in order to encourage more of Argentina's employers to register their employees.

For more information on the Extension Decree, please contact Federico Laurens

(+5411.5281.6000) or Daniel H. Dicásolo (+5411.5281.6000) from Estudio Bunge – Bunge, Smith & Luchía Puig – Abogados in Buenos Aires, a member of the Squire Sanders Legal Counsel Worldwide Network.

GERMANY

Low Taxes on German Real Property Investments

Word is spreading that Germany is no longer a high tax jurisdiction. Indeed, with an aggregate profit tax rate of slightly below 30 percent, Germany currently has the lowest profit tax rate among the industrialized G7 countries. This places Germany on the same level as countries generally perceived as low tax jurisdictions – e.g., Luxembourg.

Few people know that it gets even better in the context of German rental income or capital gains from the sale of Germany's real property. Low taxation combined with Germany's comparatively low prices and potential for investment growth are quite an attraction for international property players; this is ample reason to take a closer look at the details as well as tax planning options from the perspective of investors outside Germany – who are heeding the call and have accounted for roughly two-thirds of all property transactions in 2007.

If structured diligently, income from real property is only taxed at 15.825 percent in Germany. It is important to note (i) that this rate applies not only to rental income but also to capital gains, (ii) that offshore investors lacking tax treaty protection are not discriminated against and (iii) that private investors should use a corporate entity as a property holding vehicle – and design the structure with care.

The trick is that the investor needs to avoid being treated as a trading or service business. If that can be achieved, rental income and capital gains will be exempt from German Trade Tax of approximately 15 percent. In effect, such Trade Tax exempt investment income would then only be subject to the 15.825 percent mentioned above in the hands of a non-Germany-based corporate holding vehicle.

Given the drastic tax difference between trading income (approximately 30 percent) and investment income (approximately 15 percent), Germany's tax authorities are not very relaxed in conceding investment income. Quite the contrary – the tax collector is more than happy to take advantage of the most minimal "technicalities" of the property investment, which may trigger trading-type income. A good example is a recent case in which the investor rented out not only real property for €13,000 per month but also movable property for the minuscule amount of €230 per month. The Supreme Tax Court held that the lease of movable property constitutes trade income and that the investor is thus treated as a trader, making him subject to Trade Tax on his entire income including the rental income.

This case shows that avoiding such pitfalls is crucial in order to take advantage of the low tax rate. The idea is to structure the investment with as many defense lines against trading income as possible. *Inter alia*, the following should be considered in this context:

- **Germany-based or foreign acquisition entity** – EU acquisition entities, for example, are protected by various EU legislation from discrimination in Germany. The same is true for taxation, as EU entities enjoy tax treaty protection. In contrast, Germany-based entities are subject to any and all negative domestic tax changes – without being protected by an EU or tax treaty – and thus, are subject to greater risk.
- **Generate pure real property income** – The case above illustrates what risks are involved in mixed income streams.
- **New German thin capitalization regulations** – These new regulations restrict interest deductions exceeding 30 percent of earnings before interest, taxes, depreciation and amortization (EBITDA). It is important to know that these restrictions apply to any kind of interest whether paid to a shareholder or to a bank. Given the traditionally high leverage used in property investments, parties should carefully consider the new thin cap regulations and take advantage of the prescribed annual interest threshold of €1 million per entity. For example, a leverage of €20 million at an interest rate of 5 percent will be completely disregarded and safe as all interest will be deemed deductible no matter what the EBITDA may be. However, if the interest amount exceeds the prescribed threshold only by €1, the general regime is applicable and the 30 percent of EBITDA rule applies to the whole interest amount. We will likely see a trend of splitting or setting up more entities and single property vehicles because the €1 million threshold applies per company.
- **EU holding location** – Although not strictly required, the traditional EU entry points for offshore investors have been Luxembourg and the Netherlands. Luxembourg has increased its weight by recently signing a tax treaty with Hong Kong through which many funds including offshore funds are channelled. Cyprus is also a jurisdiction to look at as it typically does not tax foreign-source property income or apply dividend withholding tax on the transfer of profits to an offshore location lacking a tax treaty.
- **Transaction taxes** – These consist of VAT and real estate transfer tax. The latter amounts to 3.5 percent and 4.5 percent (Berlin) of the transaction value. Tax planning opportunities exist – e.g., if

the investor is willing to acquire only 94 percent of a property holding company. VAT needs to be managed with care due to the sheer magnitude of the rate of 19 percent on the transaction value.

– *Thomas Busching*

China Outbound Conference 2009 Clarifies Policy, Legal and Tax Issues for Investors

China Outbound Investment Conference 2009, hosted by LexisNexis, was held at Yunnan Crown Plaza on September 10 and 11. Panelists and guests discussed policy, legal and tax issues in relation to outbound investment.

This conference was sponsored by Squire Sanders and two US-based international law firms. Panelists from governmental authorities, international and China-based law firms, international accounting firms, consulting firms and investment firms shared their experience. Panelists from governmental authorities, including officers from the Ministry of Commerce, introduced the outbound investment approval procedure China-based companies must follow; officers from the State Administration of Taxation introduced China's latest tax preference policy for outbound investment and its impact on China-based companies intending to invest outside the country; officers from the National Development and Reform Commission commented on outbound investment policy, M&A and the role government played in such investments; and officers from the State Administration of Foreign Exchange in charge of capital affairs explained the latest foreign exchange policy on outbound investment.

Lawyers and other experts from the private sector spoke on some common problems regarding outbound investments. Squire Sanders Shanghai Partner Rainer Burkardt delivered a presentation on Germany's investment environment and its legal requirements. Mr. Burkardt analyzed local legal requirements and their advantages and reform under EU law. He also pointed out important issues China-based companies should pay attention to when acquiring Germany-based companies. He also included valuable suggestions from the commercial and company culture perspectives. For more information on Mr. Burkardt's presentation, please see his PowerPoint presentation "Legal Environment for Chinese Companies in Germany."

In the News

Amy L. Summers, partner in the Shanghai Office, was quoted by the *21st Century Business Herald* on May 25, 2009 regarding judicial collaboration between China and the United States. For full content, see the online version of the article.

Amy L. Summers was quoted by *21st Century Business Herald* on May 28, 2009 on the alleged violation of the Foreign Corrupt Practices Act by Morgan Stanley's real estate partner. For full content, see the online article.

Daniel F. Roules, Shanghai partner, was quoted by *21st Century Business Herald* on June 19, 2009, suggesting that a close eye should be kept on the application of EU and German antimonopoly laws to the establishment of joint ventures between global companies.

21st Century Business Herald (September 10, 2009) published an article by **Daniel F. Roules**, "Investment in US: Risks of Chinese Companies' Globalization." For full text, please see the online article.

Amy L. Summers was interviewed by *Labor News* as part of its series report Foreigner in Shanghai.

SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

走出中国 CHINA OUTBOUND

Contacts：

北京办公室

Sungbo Shim (沈成辅)
James M. Zimmerman (吉莫曼)

Squire, Sanders & Dempsey L.L.P.
25th Floor, North Tower, Suite 2501
Beijing Kerry Centre
1 Guanghua Road, Chaoyang District
Beijing 100020
People's Republic of China

+86.10.8529.6998

上海办公室

Daniel F. Roules (陆大安)
Amy L. Sommers （李雅美）
Rainer Burkardt (博凯德)
Charles R. McElwee II (李康熙)

Squire, Sanders & Dempsey L.L.P.
Suite 1207, 12th Floor
Shanghai Kerry Centre
1515 Nanjing Road West
Shanghai 200040
People's Republic of China

+86.21.6103.6300

香港办公室

James S. Tsang （曾世昌）
Nicholas Chan (陳曉峰)
Francis Li (李澤恩)

Squire, Sanders & Dempsey
24th Floor, Central Tower
28 Queen's Road Central
Central, Hong Kong
Hong Kong SAR, China

+852.2509.9977

东京办公室

Ken Kurosu （黒须 贤）

Squire Sanders
Gaikokuho Kyodo Jigyo Horitsu Jimusho
Ebisu Prime Square Tower, 16F
1-1-39 Hiroo
Shibuya-ku, Tokyo 150-0012
Japan

+81.3.5774.1800

NORTH AMERICA
Cincinnati
Cleveland
Columbus
Houston
Los Angeles
Miami
New York
Palo Alto
Phoenix
San Francisco
Tallahassee
Tampa
Tysons Corner
Washington DC
West Palm Beach

LATIN AMERICA
Bogotá+
Buenos Aires+
Caracas
La Paz+
Lima+
Panamá+
Rio de Janeiro
Santiago+
Santo Domingo
São Paulo

EUROPE & MIDDLE EAST
Bratislava
Brussels
Bucharest+
Budapest
Dublin+
Frankfurt
Kyiv
London
Moscow
Prague
Riyadh+
Warsaw

ASIA
Beijing
Hong Kong
Shanghai
Tokyo

+Independent network firm

www.ssd.com