International Investment and Development Committee

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This article reports on general developments affecting cross-border international investments, as well as a regional review of the most recent developments in this area. We begin with one of the major cross-border issues of the past year—the "regulation" of sovereign wealth funds.

I. International Monetary Fund Issues Generally Accepted Principles and Practices for Sovereign Wealth Funds*

In the current financial environment, where market confidence is dwindling, the International Monetary Fund (IMF) is working to bolster confidence in cross-border investments.[1] The Working Group on Sovereign Wealth Funds issued the Generally Accepted Principles and Practices (GAPP) on October 11, 2008.[2] The overall goal of these principles is to diminish the negative response the funds have received in the past year, specifically from countries receiving the funds' investments.

Since early 2007, sovereign wealth funds have grown in notoriety as new funds emerged in critical countries, and the assets within the funds increased.[3] Sovereign wealth funds are defined as "government investment vehicles funded by foreign exchange assets and managed separately from official reserves."[4] The state-owned nature of the funds raised

* Contributed by Minal Patel.

1. *Sovereign Wealth Funds Will Help Cross-Border Investments*, IMF SURV. MAG., Sept. 3, 2008, http://www.imf.org/external/pubs/ft/survey/so/2008/NEW090308B.htm.

2. International Working Group of Sovereign Wealth Funds, http://www.iwg-swf.org/index.htm (last visited Mar. 28, 2008). The GAPP are also known as the Santiago Principles.

3. The major countries that have raised alarm are oil rich countries and China. These countries established their funds during the course of 2007.

4. Robert M. Kimmitt, *Public Footprints in Private Markets*, FOREIGN AFF., Jan./Feb. 2008, at 119, *available at* http://www.foreignaffairs.org/20080101faessay87109/robert-m-kimmitt/public-footprints-in-private-markets.html. These funds have actually existed since the 1950s but have recently been coined sovereign wealth funds. Sovereign wealth funds have raised concerns due in part to the type of countries establishing these funds and the methods used to control and invest the assets. There are different types of sovereign wealth funds, and one of the difficult issues the IMF has grappled with is developing a set of principles that all sovereign wealth funds could implement regardless of their purpose and investment goals.

concerns, including the lack of transparency, the potential disruption these funds can cause to the markets, and the risk of political influence over investment decisions.[5] The IMF working group drafted GAPP to address these growing concerns.

The GAPP is a negotiated document that reflects several compromises among major sovereign wealth funds in its twenty-four voluntary principles.[6] It establishes a framework for acceptable governance, accountability, and investment practices.[7] The principles address broad concepts regarding the type of legal framework the funds should implement; identify practices of governance to which the sovereign wealth funds should adhere; and place a heavy emphasis on disclosure (particularly regarding the fund's purpose; the relationship between the central government and the fund management; and the fund's procedures and policies on funding, withdrawing, and spending within the fund).[8] GAPP also addresses another major concern: political motivation and political involvement within the management of sovereign wealth funds. Rule 19.1 states that sovereign wealth funds should publicly disclose any decisions subject to considerations other than economic or financial.[9]

The GAPP has been positively received by sovereign wealth funds, countries receiving investments from the funds, and researchers and experts in the market. But there are some reservations and concerns with certain aspects of GAPP. For example, GAPP is strictly voluntary. The IMF will need to establish a group to oversee the continuing conduct of the funds and to tackle any issues that may arise as GAPP is implemented over the coming year.[10] Also, though the principles do require disclosure, there are few requirements for disclosure to the public. The transparency and accountability principles are, therefore, still somewhat weak.[11]

Also, a factor that affects cross-border investments is the Organization for Economic Co-operation and Development's (OECD) response to GAPP. Many OECD member countries are host countries that receive investments from sovereign wealth funds. The

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5. Edwin M. Truman, *The Blueprint for Sovereign Wealth Fund Best Practices*, PETERSON INST. FOR INT'L ECON., Apr. 2008, *available at* http://www.petersoninstitute.org/publications/pb/pb08-3.pdf.

6. Edwin Truman, *Making the World Safe for Sovereign Wealth Funds*, RGE MONITOR, Oct. 18, 2008, http://www.rgemonitor.com/globalmacro-monitor/254068/making_the_world_safe_for_sovereign_wealth_funds.

7. *International: SWF Code of Practice Builds Trust*, INT'L HERALD TRIB., Oct 16, 2008, *available at* http://www.iht.com/articles/2008/10/16/business/16oxan-SWF.php.

8. Int'l Working Group of Sovereign Wealth Funds [IWG], *IWG Generally Accepted Principles and Practices (GAPP)—Santiago Principles* (Oct. 2008), http://www.iwg-swf.org/pubs/gapplist.htm [hereinafter Santiago Principles].

9. *Id.* at GAPP 19.1. The issue of political motivations was a major concern that was raised, particularly by the OECD nations. This concern has spurred many countries, including the United States, to strengthen their national security scrutiny of cross-border investments. At the end of 2007, the United States enacted the Foreign Investment and National Security Act of 2007 (FINSA). FINSA reorganized the Committee on Foreign Investment in the United States (CFIUS) process used to prohibit the investments from particular sources. *See generally*, Org. for Econ. Cooperation & Dev. [OECD], *OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies*, C/MIN(2008)8/FINAL (June 5, 2008), *available at* http://www.olis.oecd.org/olis/2008doc.nsf/LinkTo/NT000032DE/$FILE/JT03247225.PDF [hereinafter OECD Declaration].

10. *See Truman*, *supra* note 6.

11. GAPP calls for disclosure to the fund's management instead of general public disclosure. The disclosure to the public, specifically to the citizens of the country that has established the sovereign wealth fund and the country that will receive the investments, is important to ensure confidence and trust. Santiago Principles, *supra* note 8; *see Truman*, *supra* note 6.

IMF developed and established GAPP in part due to the barriers that host countries implemented in the past year.[12] The OECD has issued statements in support of the IMF's GAPP and reinforced its stance that member countries should be open to investments by sovereign wealth funds.[13] In June 2008, the OECD issued principles for countries receiving investments from sovereign wealth funds. While the report specifically addressed sovereign wealth funds, the principles merely rearticulated the long-standing OECD commitments to promote an open global investment environment.[14] During the presentation of GAPP, IMF directly articulated its expectations, stating that recipient countries should not treat sovereign wealth funds and other foreign or domestic investors in similar circumstances differently.[15] The OECD was criticized for falling behind the IMF in its efforts to ensure that principles and practices in host countries are not discriminatory.

There will be more developments in the coming year concerning sovereign wealth funds. One of the issues the IMF will likely need to address is the concept of host countries blocking investments due to national security concerns. The IMF and OECD will hopefully work in a more collaborative role than they have this past year in establishing a framework for sovereign wealth funds and host countries. Overall, the IMF's effort in establishing GAPP will help cross-border investments.

II. Canada*

A. Competition Law

On June 26, 2008, the Competition Policy Review Panel released its report on Canada's competition and investment policies, entitled "Compete to Win."[16] The federal government created the Panel in July 2007 with the mandate of examining how to improve the domestic and international competitiveness of the Canadian economy.

The Panel offered several far-reaching proposals to amend Canadian competition law. Of particular interest for these purposes is the Panel's recommendation to amend the merger notification process under Canada's Competition Act to mirror the U.S. Hart-Scott-Rodino Antitrust Improvements Act process.

Under Canada's current merger review process, transactions that exceed certain financial thresholds and, in the case of share acquisitions, that exceed an additional voting interest threshold, cannot be completed before the expiration of a statutory waiting period of either fourteen or forty-two days following the filing of a notification containing certain prescribed information. The duration of the statutory waiting period depends on whether the acquiror elects to make a short form filing (fourteen-day waiting period) or a long form filing (forty-two-day waiting period). The Bureau's substantive review of transactions, however, runs on a different non-statutory timetable based on the complexity of

12. The U.S. enactment of the Foreign Investment and National Security Act of 2007 is a clear example.

13. Angel Gurria, OECD Secretary-General, Remarks at the IMF Ministerial-level Roundtable on the "Santiago Principles" for Sovereign Wealth Funds (Oct. 11, 2008), http://www.oecd.org/document/59/0,3343,en_2649_34487_41501371_1_1_1_1,00.html.

14. *See* OECD Declaration, *supra* note 9; *see generally* Truman, *supra* note 6.

15. Truman, *supra* note 6.

* Contributed by Mark Katz, with Davies Ward Phillips & Vineberg LLP.

16. The Panel's report and related materials are available at Competition Policy Review Panel, Compete to Win, http://www.ic.gc.ca/epic/site/cprp-gepmc.nsf/en/home (last visited Mar. 28, 2009).

the transaction. According to the Bureau's non-binding "service standard" periods, it will aim to complete its substantive review of "non-complex" transactions within two weeks; within ten weeks for "complex" transactions; and within five months for "very complex" transactions.

Canada's merger review process creates uncertainty for merging parties at various levels. For one, parties must themselves elect whether to file a short form or long form notification, assuming the risk that if they file a short form, the Bureau may require them to re-submit a long form, thereby stopping the waiting period until the long form filing is made. In addition, because the statutory waiting periods and the Bureau's "service standard" review periods are not correlated, merging parties can find themselves in a position where the waiting period has expired (legally entitling them to close) without the Bureau having completed its substantive review. Parties must then decide whether to wait until the Bureau is done or proceed to closing subject to the risk that the Bureau may seek an injunction to stop them.

The uncertainties in the Canadian merger system have led to suggestions that the process be amended by establishing a clearer series of deadlines, with an initial review period of set duration followed by a longer second phase of investigation for mergers that raise substantive issues.

The Panel appears to have agreed with this perspective in recommending that the merger review process in Canada be aligned with the U.S. Hart-Scott-Rodino Antitrust Improvements Act (HSR) process.[17] The HSR process involves an initial thirty-day waiting period in which a notified merger may not be completed, and the government can assess the likely competitive effects of the proposed transaction. Before that thirty-day period expires, the government may choose to issue a "second request" for information and documents, in which case the proposed transaction may not be completed until thirty days after the parties substantially comply with the request. There is also only a single form of filing form (i.e., no short form/long form dichotomy).

Although a step in the right direction, the Panel's preference for the wholesale adoption of the U.S. merger system—including the lengthy and onerous "second request" process—could actually create inefficiencies by significantly raising the costs and lengthening the potential delays for merger review in Canada. Given the Panel's stated goal of reducing the time, complexity, and cost of the Canadian merger review process, it would have been preferable for the Panel to have included in its recommendations a workable deadline within which a second stage review would have to be concluded (as is done in many other jurisdictions).

The Panel makes several other recommendations designed to reduce the scope and burden of merger review in Canada. For example, the Panel suggests that the notification thresholds be increased from their current levels of $400 million ("size of the parties" test) and $50 million ("size of the transaction" test).[18] The Panel also recommends that the period of time within which the Bureau may challenge a completed merger be reduced from three years to one year. While the Bureau has rarely challenged completed mergers,

17. Information on the process is available at Federal Trade Commission, Hart-Scott-Rodino Premerger Notification Program—Premerger Introductory Guides, http://www.ftc.gov/bc/hsr/introguides/introguides.shtm (last visited Mar. 28, 2009).

18. COMPETITION POLICY REVIEW PANEL, COMPETE TO WIN: FINAL REPORT 57 (June 2008), *available at* http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/vwapj/Compete_to_Win.pdf/$FILE/Compete_to_Win.pdf.

the Panel's report notes that "[a] shorter period in which to challenge a transaction would provide more certainty for the Canadian business community and international investors."[19]

B. Foreign Investment

Canada elected a new minority Conservative government in October 2008. During the election campaign, the Conservatives promised to enact very significant reforms to Canada's laws governing foreign investment in Canadian businesses. The Conservatives repeated their commitment to enact these reforms in the recent "Speech from the Throne" setting out their proposed legislative agenda.

Among other things, the Conservatives have said that they will:

- amend the Investment Canada Act (ICA) to increase the threshold for foreign investment reviews from the current level of $295 million in gross asset value to $1 billion in enterprise value, with the increase to be phased in over four years;
- ensure greater transparency in the ICA process by requiring the responsible Minister to give reasons if an investment is disallowed;
- establish a new national security review mechanism in the ICA to ensure that foreign investments cannot jeopardize Canada's national security;
- work with Canada's trading partners to ensure that foreign investment is a "two-way street" and that Canadian companies also receive increased access to investment opportunities abroad;
- increase the permissible level of foreign investment in domestic airlines from twenty-five percent to forty-nine percent through bilateral negotiations with Canada's major partners, such as Europe and the United States, that would also secure increased access to international flight routes and landing rights through Open Skies agreements; and
- revise the Non-Resident Ownership Policy for uranium mining and development, provided that Canada is able to negotiate reciprocal benefits with potential investor nations and that any foreign investments in this sector meet the national security test.

Many of these proposals reflect recommendations made by the Panel in its June 2008 report. The gist of the Conservatives' approach (and that of the Panel) is that Canada's foreign investment rules should be pared back. In particular, if adopted, the ICA's application will be restricted to very limited circumstances, principally where "national security" interests may be implicated.

This position is likely to meet with opposition from the many interests in Canada that are against the increase on foreign investment. The level of disquiet regarding foreign investment has increased over the last several years, as many Canadian "corporate icons" were acquired by foreign investors.

19. *Id.*

III. Colombia*

On October 8, 2008, the Ministry of Finance enacted Decree 3913[20], which was followed the next day by the implementation of Resolution 10[21] issued by the Board of Directors of the Central Bank. These measures are intended to mitigate the effects of the worldwide financial crisis on the Colombian economy. Pursuant to these measures, the mandatory deposit with the Central Bank of a percentage of any foreign exchange transactions involving foreign indebtedness, the remittance to the country of origin of non-perfected direct foreign investments, and the registration of portfolio foreign investment was cut down to zero percent. Accordingly, none of the above-listed foreign exchange transactions are subject to any deposit requirement.[22]

This measure aims to attract new sources and inflows of foreign investment into the country and mitigate the extraordinary fluctuations that foreign exchange had throughout the year. The fact that the deposit obligation has been reduced to a zero percent rate but has not been completely eliminated, however, has generated concern as this formula is perceived as a temporary measure that the Government may revisit in the future. It is thus expected that there will be strong pressure from the business community to seek a permanent elimination of the Central Bank deposit obligation.

Resolution 10 also amended the regime applicable to free trade zones users, eliminating the special foreign exchange rules that applied to Colombian residents operating in such zones. This change means that free trade zones users have to channel through the foreign exchange market any currency stemmed from their foreign exchange transactions.[23]

Finally, Decree 3264, dated September 1, 2008, lifted both the obligations to maintain foreign investment for a minimum of two years and the prohibition on repatriating capital contributions before the end of such two-year term.[24] As a result, there is no longer any minimum-stay requirement for foreign investment in Colombia.

* Contributed by Jaime Herrera, a partner at Posse, Herrera & Ruiz in Bogotá, Colombia.

20. Decreto No. 3913, 8 de octubre de 2008, Gaceta Oficial de la República de Colombia [Official Gazette], *available at* http://web.presidencia.gov.co/decretoslinea/2008/octubre/08/dec391308102008.pdf.

21. Banco de la República de Colombia, Boletín No. 46, 9 de octubre de 2008, *available at* http://www.banrep.gov.co/documentos/reglamentacion/cambiaria/2008/Bol_46_2008_CRE_DODM_143_Oct9.pdf.

22. Before, this deposit obligation amounted to forty percent of the funds involved in any of the above referred foreign exchange transactions for a six-month period and was interest-free.

23. Prior to the enactment of Resolution 10, users of free trade zones were only obligated to channel through the foreign exchange market any foreign currency indebtedness with a term of maturity higher than six months and in amounts exceeding US$10,000 or its equivalent in other currencies.

24. Decreto No. 3264, 1 de septiembre de 2008, Gaceta Oficial de la República de Colombia [Official Gazette], *available at* http://www.minhacienda.gov.co/portal/page/portal/MinHacienda/elministerio/prensa/DECRETO3264.pdf.

IV. India*

A. Pre-Merger Notification Requirements

The pre-merger notification requirements, introduced by a September 2007 amendment to the Competition Act of 2002 (Competition Act), are yet to come into force.[25] The applicable provisions of the Competition Act have not been notified in the Official Gazette. Draft regulations, however, have been issued in the meantime for comment. We offer this analysis.

The amended Competition Act requires that the parties to a merger or acquisition notify the Competition Commission of India (Competition Commission) if the proposed combination exceeds the threshold limits specified in the Competition Act.[26] Notice must be given within thirty days of (a) approval of the proposal for merger by the board of directors of the concerned enterprises or (b) execution of any agreement or other document for the acquisition or acquiring control of another enterprise.[27]

The Competition Commission then has 210 days to issue its decision. No combination can come into effect until approval is received or 210 days have elapsed.[28] In essence, a proposed qualifying merger or acquisition must be put on hold during this time.

B. Taxation of Offshore Transactions–The Vodafone Case

Transactions involving non-residents are receiving increased scrutiny from income tax authorities in India. The tax authorities have been taking a very aggressive position vis-à-vis taxing non-residents on gains realized in offshore transactions that have an India connection. The proceedings in *Vodafone Essar Ltd. v. India Ministry of Finance*[29] pending before the Bombay High Court are a case in point. They amount to a significant expansion of the extra-territorial effect of Indian income tax laws and are being closely watched as they could adversely affect overseas merger and acquisition transactions indirectly involving an Indian subsidiary.

The *Vodafone* case arose from the purchase in 2007 by Vodafone International Holdings BV, a Dutch company, from a Cayman Islands company, of shares in a Cayman Islands holding company. The holding company held an indirect interest in a mobile phone company in India. In this case, both the buyer and seller were non-residents (and therefore not otherwise subject to tax in India), and the capital gain arose from the transfer of shares in a holding company outside India. The holding company held its interest in the Indian company through a series of tax haven companies.

The tax authorities contend that the gain arising from the offshore transaction is taxable in India, as it arises from the transfer of a capital asset located in India, namely the shares in the Indian mobile phone company. Accordingly, the tax authorities argue that the gains

* Contributed by Anand S. Dayal, partner at Koura & Company, Advocates and Barrister, in New Delhi, India.

25. The Competition Act, Act 12 of 2003; India Code (2003).

26. The Competition (Amendment) Act, No. 70 of 2007; India Code (2007), v. 12.

27. *Id.* § 4.

28. *Id.* § 31.

29. Vodafone Essar Ltd. v. India Ministry of Finance, Writ Petition No. 1942 of 2007 (Bombay H.C. filed July 9, 2007).

are "deemed to accrue or arise in India" under section 9(1) of the Indian Income Tax Act of 1961[30] and are therefore taxable in India.[31]

C. Foreign Investment Regulation-Mixed Trend

The government continues to pursue foreign direct investment (FDI) by opening up additional activities and sectors to foreign investment. But the trend has been mixed. While caps and other conditions on foreign ownership have been relaxed, there are exceptions—commodity exchanges and credit information companies—wherein new caps and other restrictions on foreign ownership have been imposed that did not previously exist. Also, certain sectors remain off-limits for foreign investors, including real estate (other than in a narrow range of qualifying projects) and retail (other than single brand stores), and there is no increase in the foreign ownership cap (twenty-six percent) for insurance companies. The key policy changes are summarized below.

- *Civil aviation (air transport services)*-The cap on foreign ownership was increased from forty-nine percent to seventy-four percent for non-scheduled airlines, chartered airlines, and cargo airlines (but not for scheduled domestic airlines), subject to there being no direct or indirect participation by foreign airlines (except in case of cargo airlines). Certain related activities have also been opened up for foreign investment, subject to specific conditions.[32]
- *Petroleum & Natural Gas (trading and marketing of petroleum products)*-The existing cap (100 percent) on foreign ownership was freed of the somewhat burdensome condition that a compulsory divestment of twenty-six percent of the equity be made in favor of domestic shareholders within five years.[33]
- *Petroleum refining*-The cap on foreign ownership was increased from twenty-six percent to 49 percent for government-owned refining companies. Private refining companies were already allowed to be 100 percent foreign owned.[34]
- *Commodity exchanges*-There is a composite cap of forty-nine percent on foreign ownership comprised of sub-caps of twenty-six percent on FDI, twenty-three percent on foreign institutional investment (FII), and five percent by any single investing entity. Prior governmental approval is required for any FDI, and all FII share purchases are restricted to acquisitions on the secondary market.[35]
- *Credit Information Companies*-There is a composite cap of forty-nine percent on foreign ownership with a sub-cap of twenty-four percent on FII investment with no

30. Effective from April 1, 1962.

31. *See Triniti Corp.*, 295 I.T.R. 258 (Auth. for Advanced Rulings Nov. 16, 2007), *available at* http://rulings.co.in/ruling/show_ruling/170.html.

32. Press Release, Ministry of Commerce & Indus., Changes Approved in the Policy of FDI Investment (Mar. 5, 2008).

33. *Id.*

34. *Id.*

35. Reserve Bank of India (RBI), AP (DIR Series) Circular No. 41, Foreign Investment in Commodity Exchanges-Amendment to the Foreign Direct Investment Scheme (Apr. 28, 2008), *available at* http://rbidocs.rbi.org.in/rdocs/notification/PDFs/84219.pdf.

single FII directly or indirectly owing more than ten percent. Additional conditions apply.[36]

In the case of commodity exchanges and credit information companies, the changes impose new restrictions that did not previously exist. The existing policy has neither specifically prohibited foreign ownership nor affirmatively allowed it in the sector-specific policy statements forming part of the FDI policy. Therefore, these activities previously fell within the residuary category of activities not specifically excluded, for which 100 percent foreign ownership was permissible.[37]

D. Restrictions on Foreign Debt Partly Relaxed

The near-total ban on the use of foreign debt to fund Rupee expenditures in India has gradually been relaxed. The Reserve Bank of India (RBI) has, over the course of several notifications, relaxed the ceiling placed on such borrowings. As of today, foreign debt can be incurred to fund Rupee expenditures up to US$500 million, subject to certain conditions.[38]

Since August 2007, the RBI has severely curtailed the use of external commercial borrowing (ECB) to meet Rupee expenditure in India.[39] ECB are loans and other forms of debt taken by Indian borrowers from foreign lenders, including financial institutions and joint venture partners. The August 2007 change limited the use of ECB for domestic Rupee expenditure to no more than US$20 million per financial year, with prior approval of the RBI.[40] Essentially ECB could, with certain exceptions, be used only to fund the import into India of capital goods. These curbs have been relaxed.

In addition to these new provisions allowing access to ECB for Rupee expenditure, other policy changes include:

- raising the "all-in-cost" ceiling (interest and all other lender charges and expenses) to 500 basis points above six-month LIBOR for the currency of loans having an average maturity of more than five years;[41]
- allowing services sector participants (including hotels, hospitals, and software companies) to avail themselves of ECB up to US$100 million per year for the import of capital goods. Previously, only the real estate sector was permitted to use ECB;[42]

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36. RBI, AP (DIR Series) Circular No. 40, Foreign Investment in Credit Information Companies-Amendment to the Foreign Direct Investment Scheme (Apr. 28, 2008), http://rbidocs.rbi.org.in/rdocs/notification/PDFs/84217.pdf.

37. Press Release, Dr. Ashwani Kumar, Minister of State for Industry, Government of India, Changes Approved in the Policy of FDI Investment (Mar. 5, 2008).

38. Press Release, Ministry of Finance, External Commercial Borrowings Policy Reviewed (Oct., 23, 2008), http://pib.nic.in/release/release.asp?relid=44105 [hereinafter Ministry of Finance].

39. RBI, AP (DIR Series) Circular No. 4, Review of External Commercial Borrowing Policy (Aug. 7, 2007), *available at* http://rbidocs.rbi.org.in/rdocs/notification/PDFs/79171.pdf.

40. *Id.*

41. Ministry of Finance, *supra* note 38.

42. RBI, AP (DIR Series) Circular No. 46, External Commercial Borrowings (ECBs) by Services Sector-Liberalization (June 2, 2008), *available at* http://rbidocs.rbi.org.in/rdocs/notification/PDFs/84761.pdf.

- approving RBI for the creation of security (mortgage of land, pledge of shares) in favor of the foreign lender delegated to the bank in India that manages the borrowing;[43] and
- allowing Indian companies to issue Foreign Currency Exchangeable Bonds exchangeable at the option of the holder into equity shares in a company listed on the stock exchange in India other than the issuing company (provided that both companies belong to the same promoter group).[44]

E. Outbound Investment–Energy and Natural Resources Sector

The Indian government encourages outbound investments by Indian companies.[45] The aggregate outbound investment, however, is limited to 400 percent of the net worth of the Indian acquirer under the "automatic" route (without prior approval). These restrictions have been relaxed in the case of overseas investments in the petroleum and natural resources sector, as described below.

- investments in "energy and natural resources sectors such as oil, gas, coal and mineral ores" are no longer capped at 400 percent of the net worth of the investing Indian company.[46] The cap can be exceeded only with prior approval of the RBI.
- investments in government-approved overseas unincorporated entities in the upstream petroleum sector (exploration and drilling for oil and natural gas) are permitted under the automatic route (without prior government approval).[47] Previously investments in unincorporated entities outside India were not allowed, except by certain public sector oil companies.

F. Tax Exposure Of Foreign Outsourcers Clarified

In its *Morgan Stanley* decision, the Supreme Court of India significantly reduced the uncertainty in the income tax exposure of foreign companies that outsource back office operations to captive service providers in India.[48] Foreign companies have been concerned that India may tax them if they establish a captive back office operation, because such an operation may be viewed as a "permanent establishment" of the foreign company in India. In the *Morgan Stanley* case, the pertinent issues before the Court were (A) whether the services provided by a captive business process outsourcing unit of a foreign company would create a permanent establishment of the foreign company in India and (B) if so, what amount of income will be attributable to such permanent establishment. On

43. RBI, AP (DIR Series) Circular No. 17, Security for External Commercial Borrowings—Liberalization (Sept. 23, 2008), *available at* http://rbidocs.rbi.org.in/rdocs/notification/PDFs/85685.pdf.

44. RBI, AP (DIR Series) Circular No. 17, Issue of Foreign Currency Exchangeable Bonds Scheme, 2008 (Sept. 23,2008), *available at* http://rbidocs.rbi.org.in/rdocs/notification/PDFs/87094.pdf.

45. RBI, Master Circular No. 1/2008-09, Master Circular on Direct Investment by Residents in Joint Venture (JV)/Wholly Owned Subsidiary (WOS) Abroad ¶ A.1 (July 1, 2008), *available at* http://rbidocs.rbi.org.in/rdocs/notification/PDFs/85336.pdf.

46. RBI, AP (DIR Series) Circular No. 48, *Overseas Investments-Liberalization/Rationalization* (June 3, 2008), *available at* http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/84773.pdf.

47. *Id.*

48. Director of Income Tax, Mumbai v. Morgan Stanley and Co., [2007] [Supreme Court] 2007 S.C.C. 1 (India), *available at* http://www.cainindia.org/news/7_2007/morgan_stanley_has_service_permanent_establishment_in_india_sc.html.

issue (A), the court held that outsourcing support services to a captive service provider does not create a permanent establishment. With regard to issue (B), the court held that where the transactions between the foreign company and its captive service provider in India are conducted on an "arm's length basis taking into account all the risk-taking functions of the multinational enterprise," the foreign company would not be further taxed in India on the service provider's activities.[49] Of course, the service provider itself is subject to tax in India.

G. Ban on Foreign Investment via Participatory Notes Lifted

In October 2008, the Securities Exchange Board of India (SEBI)[50] lifted the ban imposed in October 2007 on the issuance by FIIs of offshore derivative instruments (such as participatory notes (PN)) to overseas investors in the Indian stock market. Removal of the ban was intended to stimulate FII investments, as the stock market was experiencing heavy FII redemptions in response to global economic conditions.

The ban and subsequent partial relaxation affects foreign investors who have been investing with relative anonymity through PNs issued by FIIs registered with SEBI. The Government and regulators such as the RBI and SEBI were concerned about "the year on year increase in [PNs], the anonymity that the [PN] provides to the investors and the copious inflows into the country from foreign investors[. . . .]"[51] Accordingly, SEBI announced the following measures (that were subsequently rescinded), effective after close of trading hours on October 25, 2007:[52]

- Specific sub-accounts of FII can no longer issue PNs, but FIIs may continue to do so. Existing PNs issued by sub-accounts will have to be wound up within eighteen months after the effective date given above.
- The aggregate PN issuance by an FII must not exceed 40 percent of the assets under custody of the FII as of September 30, 2007. FIIs whose present PN issuance is below the aforesaid cap may increase the level of PN issuance up to the cap by no more than 5 percent of assets under custody per year.

H. Other Important Legislative Initiatives

1. *Companies Bill, 2008*

The new Companies Bill of 2008 was approved by the Union Cabinet on September 29, 2008. It will, when enacted, replace the existing Companies Act, 1956 in its entirety and "seeks to enable the corporate sector in India to operate in a regulatory environment of best international practices that fosters entrepreneurship, investment and growth [. . . .]"[53]

49. *Id.* at para.33.
50. Press Release No. 202/2008, Securities Exchange Board of India (SEBI), SEBI Board Meeting (Oct. 6, 2008), *available at* http://www.sebi.gov.in/press/2008/2008202.pdf.
51. SEBI, Paper for Discussion on Offshore Derivative Instruments (Participatory Notes) (Oct. 16, 2007), *available at* http://www.sebi.gov.in/commreport/OffshoreDerivative.pdf.
52. Press Release No. 286/2007, SEBI, SEBI Board Meeting (Oct. 25, 2007), *available at* http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec_id=25&sub_sec_id=25.
53. Press Release, Ministry of Corporate Affairs, Companies Bill 2008 (Sept. 29, 2008), *available at* http://www.mca.gov.in/MinistryWebsite/dca/press/press/PressRelease_Companies_Bil_2008_15sep2008.pdf.

2. *Limited Liability Partnership Bill, 2008*

This bill provides for the formation and regulation of limited liability partnerships (LLP), a corporate form that hitherto did not exist in India. The government has long recognized the need for LLP legislation in India to provide businesses with a framework that offers "flexibility suited to requirements of service, knowledge and technology based enterprises."[54]

V. Palestine*

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The legal environment has changed little in Palestine since 2007; as of the date of this publication, the Palestinian Legislative Council (PLC) has passed no new laws. The causes of the legal stagnation remain unchanged from 2007. A significant portion of PLC members, almost one-third, is currently jailed by Israeli authorities.[55] Additionally, internal strife continues between Fatah and Hamas.[56] The PLC has therefore been unable to convene to pass new legislation.

This legislative void has been partially filled by the Palestinian Authority's (PA) executive branch headed by President Mahmoud Abbas. Under the Palestinian Basic Amended Law of 2003, the President of the PA has the authority to issue executive decrees that have the same effect as legislatively passed laws.[57] Once the PLC is able to reconvene, all executive decrees must be either adopted by the PLC or otherwise lose their effect.[58] In 2007, President Abbas issued some fifty executive orders, while in 2008 this number dropped to twenty-five.[59] Most of the executive orders are administrative in nature, such as appointing new council members for the PA's Christian Affairs Committee,[60] appointing new members to the military court,[61] and changing the name of a research institution.[62] But the President substantially revised the Income Tax Code Law No. 17 of

54. Press Release, Ministry of Corporate Affairs, Limited Liability Partnership Bill, 2008 Introduced in Rajya Sabha (Oct. 21, 2008), *available at* http://pib.nic.in/release/release.asp?relid=43936.

* Contributed by Jenna DiCocco and Hisham A. Kassim, an associate at Kalbian Hagerty LLP, Washington, DC.

55. Rory McCarthy, *Israel Releases 198 Palestinian Prisoners*, THE GUARDIAN LIMITED, Aug. 26, 2008, *available at* http://www.guardian.co.uk/world/2008/aug/26/israelandthepalestinians1; *Adam Entous & Mohammed Assadi, Palestinian Laws Get Overhaul with Little Oversight*, REUTERS, Aug. 29, 2008, *available at* http://www.reuters.com/articlePrint?articleID=USMAC91755420080829.

56. *Palestinians in Gaza and West Bank Suffer from Factional Strife*, HUMAN RIGHTS WATCH, July 30, 2008, *available at* http://hrw.org/english/docs/2008/07/30/isrlpa19482.htm.

57. Amended Basic Law, art. 43 (2003) (Palestinian Authority).

58. Amended Basic Law, art. 43 (2003) (Palestinian Authority).

59. Beirzeit University Al Muqtafi Legal Database, http://muqtafi.birzeit.edu/data/others/hicourt07.pdf (last visited Mar. 29, 2009).

60. Executive Decree No. 2/2008, Palestine Gazette, June 15, 2008, *available at* http://muqtafi.birzeit.edu/en/pg/ (follow "2008" hyperlink; then follow "Issue Seventy Five" hyperlink).

61. Executive Decree No. 117/2008, Palestine Gazette, June 15, 2008, *available at* http://muqtafi.birzeit.edu/en/pg/ (follow by "2008" hyperlink; then follow "Issue Seventy Five" hyperlink).

62. Executive Decree No. 1/2008, Palestine Gazette, June 15, 2008, *available at* http://muqtafi.birzeit.edu/en/pg/ (follow by "2008" hyperlink; then follow "Issue Seventy Five" hyperlink).

2004 so as to eliminate almost all capital gains taxes on realized gains from the sale of real estate and securities.[63]

Many commentators are concerned that executive legislation by decree is eroding Palestinian democracy.[64] Executive decrees lack transparency and accountability with a high concentration of legislative power where only a few people are involved in the decision making process.[65] The democratic process and the effect of the presidential decrees on the basic governing system in Gaza and the West Bank are the most significant aspects to watch in the current Palestinian legal and political climate.

VI. Peru*

As a result of the Free Trade Agreement entered into between Peru and the United States in 2006, which is expected to enter in force in January 2009, important new legislation concerning investment has been approved. A brief reference to the most relevant laws in this connection follows:

- Legislative Decree No. 994[66] aims to foster private investment in irrigation of uncultivated land owned by the Peruvian State by means of regulating the transfer of title in respect thereof to investors willing to commit investment to make the land cultivable. Further regulations are expected to be passed in the near future, providing additional detail on the requirements and conditions to be met by investors to access such land.
- Legislative Decree 1011[67] amended the Investment Legal Stability Regime[68] so that, by entering into an agreement with the Peruvian State, foreign and local investors, as well as the corresponding investment recipient company, can obtain stability in respect of the Income Tax regime and the free convertibility and remittance of foreign currency for a ten year term. Pursuant to this amendment, investors will be entitled to request the execution of a stability agreement within the twelve months following the undertaking of the investment. Prior to this decree, this right had to be exercised prior to the undertaking of the investment.
- Specific regulation of public private partnerships (PPP) was introduced under Legislative Decree No. 1012[69]. This decree regulates the joint participation of the State and private investors in the development, improvement, operation, and maintenance of infrastructure and the provision of public services. Under this new regime, PPPs are divided into two groups: (i) projects that are financially self sufficient and in

63. Executive Decree No. 2/2008, Palestine Gazette, June 15, 2008, *available at* http://muqtafi.birzeit.edu/en/pg/ (follow by "2008" hyperlink; then follow "Issue Seventy Five" hyperlink).

64. Adam Entous & Mohammed Assadi, *Palestinian Laws Get Overhaul with Little Oversight*, REUTERS, Aug. 29, 2008, *available at* http://www.reuters.com/articlePrint?articleID=USMAC91755420080829.

65. *Id.*

* Contributed by Jean Paul Chabaneix, partner at Rodrigo, Elías & Medrano Abogados in Lima, Peru

66. Legislative Decree 994, Official Gazette, March 13, 2008 (Peru), *available at* http://www.congreso.gob.pe/ntley/Imagenes/DecretosLegislativos/00994.pdf.

67. Legsilative Decree 1011, Official Gazette, May 11, 2008 (Peru), *available at* http://www.congreso.gob.pe/ntley/Imagenes/DecretosLegislativos/01011.pdf.

68. Created by Legislative Decree 662 and further regulated by Legislative Decree 757. *Id.*

69. Legislative Decree 1012, Official Gazette, May 13, 2008 (Peru), *available at* http://www.congreso.gob.pe/ntley/Imagenes/DecretosLegislativos/01012.pdf.

which the State support is not required or is very unlikely to be required; and (ii) projects requiring co-financing or other forms of support from the State in order to be undertaken. Further regulation on the matter is expected to be issued before year end.

- The importance that environmental control and protection have gained in the last few years in Peru led to the creation of a new Ministry of the Environment under Legislative Decree 1013[70]. This new Ministry will be in charge of centralizing policy generation and administration with respect to the environment and its preservation.
- Legislative Decree No. 1014[71] sets forth provisions aiming to promote private investment in utility infrastructure in the areas of water and sewage, electricity transmission and distribution, and natural gas and telecommunications. Among other provisions, this new law establishes the free use of public property for any development or improvement of utility infrastructure.
- Legislative Decree No 1058[72] aims to promote investment in hydro and renewable source (wind, solar, geothermic, biomass, and seawave) power generation activities by allowing for an accelerated depreciation of assets (i.e. machinery, equipment, and construction) for income tax purposes.

VII. United States of America*

A. CTFC Reauthorization Act—Retail Foreign Currency Trading

The U.S. Congress passed Commodity Futures and Trading Commission Reauthorization Act (the Act) as part of the Food, Conservation, and Energy Act in May of 2008.[73] The Act solidified the jurisdiction of the Commodity Futures and Trading Commission (the CFTC, or the Commission) over the commodity and futures industry and established new foundations for this agency. Particularly, it included jurisdiction over transactions in retail foreign currency, mandatory requirements for registration with the Commission, and a new adjusted net capital requirement of $20 million.[74] What remains to be seen as of the date of this writing is when rules and regulations by the Commission and the National Futures Association (NFA), a self-regulatory organization under the Commission's jurisdiction, will enforce these new requirements.

The retail Over-the-Counter Foreign Exchange (Forex) industry began making services available to the general public in 2000 with the passing of the Commodity Futures Modernization Act, which amended the Commodity Exchange Act (CEA).[75] Since then, clear-

70. Legislative Decree 1013, Official Gazette, May 14, 2008 (Peru), *available at* http://www.congreso.gob.pe/ntley/Imagenes/DecretosLegislativos/01013.pdf.
71. Legislative Decree 1014, Official Gazette, May 16, 2008 (Peru), *available at* http://www.congreso.gob.pe/ntley/Imagenes/DecretosLegislativos/01014.pdf.
72. Legislative Decree 1058, Official Gazette, June 28, 2008 (Peru), *available at* http://www.congreso.gob.pe/ntley/Imagenes/DecretosLegislativos/01058.pdf.
* Contributed by Anna Vidiaev, Capital Market Services LLC.
73. Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-246, § 13101, 122 Stat. 1651 (2008) (to be codified at Commodity Exchange Act, 7 U.S.C. § 2(c)(2)(B)) [hereinafter Food Act].
74. *Id.*
75. Commodity Futures Modernization Act of 2000, Pub. L. 106-554, Appendix E, 114 Stat. 2763 (2000).

ing and dealing firms facilitating Forex transactions for customers have been registering as Futures Commission Merchants (FCMs) with the CFTC. The Commission's jurisdiction was challenged, however, in the case of *Commodity Futures & Trading Comm'n. v. Zelener*[76] in 2004. In deciding whether the CEA applied to rolling spot Forex transactions, the U.S. Court of Appeals for the Seventh Circuit concluded that the type of transaction in question had no specified future date of delivery and did not involve actual contracts but rather a direct sale or purchase of a commodity.[77] As such, it did not fall within the traditional definition of a futures contract, and CFTC had no jurisdiction over this type of transaction.

The conclusion of the court in *Zelener* made it difficult for the Commission to oversee and prevent fraud and protect the retail clients. With the passing of the CFTC Reauthorization Act, new terminology and additions to the CEA provide the Commission jurisdiction over "an agreement, contract, or transaction in foreign currency. . .that is a contract of sale of a commodity for future delivery [. . .] and [. . .] is offered to [. . .] a person that is not an eligible contract participant."[78] The Act further lists a "retail foreign exchange dealer" as a separate category from the traditional FCM.[79]

The oversight over unregistered affiliates dealing with U.S. clients, many from outside of the United States, lacked enforcement measures by the legislators. Solicitors, trading advisors, and pool operators of the Forex industry have not been required to register with the Commission up until this new legislation.

Financial requirements, including a threshold of adjusted net capital firms must maintain, is intended as a solvency safety net for investors, most essential in Forex where U.S. customers' funds lack bankruptcy protection. While foreign regulatory bodies, such as the UK Financial Services Authority, focus on the variable capital requirement, taking into account the range of activities of the firm, the various risks, and fixed overhead,[80] this requirement has been a flat dollar amount in the United States.

In the past few years the NFA has raised this amount from $250,000 to $1 million and then to $5 million towards the end of 2007. The new provisions in the Act raise the requirement to $20 million,[81] and the NFA proposed that this threshold come into effect on May 16, 2009.[82] This proposal also intends to amend the existing rules for financial requirements for firms that offer high leverage options for their customers and require at least 150 percent of the amount, potentially placing some firms in a regulatory threshold requiring $30 million.[83]

Today, about two dozen Forex Dealer Members are registered with the CFTC as Futures Commission Merchants and are also members of the NFA. Many more individuals

76. *Commodity Futures & Trading Comm'n. v. Zelener*, 373 F.3d 861 (7th Cir. 2004).

77. *See id.*

78. Food Act, *supra* note 73.

79. *Id.*

80. Financial Services Authority, Full Handbook, BIPRU 2.2 Internal Capital Adequacy Standards, *available at* http://fsahandbook.info/FSA/html/handbook/BIPRU/2/2.

81. Food Act, *supra* note 73.

82. The schedule of increase requires $10 million through January 16, 2009; $15 million through May 15, 2009; and $20 million from May 16, 2009, forward. Letter from Thomas W. Sexton, Vice President and General Counsel, to David A. Stawick, Office of Secretariat, Commodity Future Trading Commission (Aug. 22, 2008), *available at* http://www.nfa.futures.org/news/PDF/CFTC/FR1_11a_12_082208.pdf.

83. *Id.*

and entities in the industry are unregistered solicitors, trading advisors, and pool operators. The CFTC has a full plate on their hands to enact rules and regulations to define a separate category and pertinent requirements for retail foreign exchange dealers; mandate registration of solicitors, trading advisors, and pool operators; and to set in place the new threshold of the adjusted net capital requirement.