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Joseph C. Guagliardo ‘Think Like a Lawyer, Talk Like a Geek 2016: Get Fluent in Technology’

Practising Law Institute

WHEN	TIME
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Editors’ Notes

Summer 2016 was a season of change. In Europe, we saw the “Brexit,” with the United Kingdom voting to withdraw from the European Union. The June referendum sent shockwaves through the business and finance communities and brought about a regime change in the UK as Theresa May took over as prime minister. Political change is on the horizon in the United States as well as we finished a raucous primary season and draw nearer to the general election. With major-party candidates who have very different ideologies, the election promises to have far-reaching impacts throughout the world.

India has also seen its fair share of change in recent months. Widespread reforms have impacted areas such as tax, arbitration and foreign direct investment. One of these changes — amendments to the India-Mauritius Tax Treaty — is discussed in this newsletter. We also saw developments related to the new Mumbai Centre for International Arbitration, which will launch later this year. We will be closely following India’s first arbitration tribunal and its effects on the state of international arbitration in the coming months. We also are having conversations with business and political leaders in India. On September 13, Pepper Hamilton and the U.S.-India Business Council hosted a senior Government of Gujarat delegation, led by Dipesh Shah, to promote the Gujarat International Finance Tec-City — a first-of-its kind global financial and IT services hub in India that is currently under development.

Despite these changes throughout the world, business continues, and we must keep up with the latest developments to stay ahead of the game. We hope our newsletter helps you remain up to date on some of the hot button issues affecting you.

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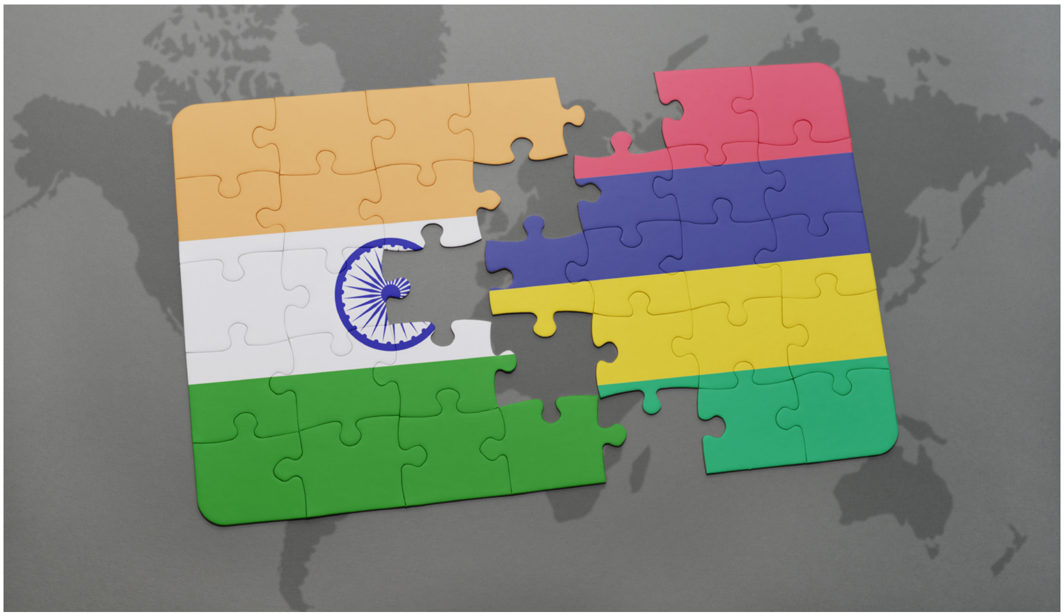
Recent Changes to the India-Mauritius Tax Treaty: What Does This Mean for American Investors?



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THE AMENDMENTS MAY CAUSE SOME UNCERTAINTY AND ANXIETY FOR U.S. INVESTORS AS THEY CONSIDER HOW THESE CHANGES WILL IMPACT BUSINESS, INCOME, PROFITABILITY AND THE BENEFITS OR DRAWBACKS OF INVESTING IN INDIA THROUGH MAURITIUS.

For many years, a useful route to invest into India was to go through Mauritius. A U.S. investor, for example, would hold an interest in a Mauritian tax resident company, and that company would hold the investment in shares of an Indian company. Until very recently, the expectation was that, on the sale of the shares in the Indian company, there would be no Indian capital gains tax imposed on the seller because of Article 13(4) of the Double Taxation Avoidance Agreement between India and Mauritius (the Treaty). On May 10, 2016, the Indian Ministry of Finance issued a press release announcing that Mauritius and India have executed a protocol that significantly amends the Treaty.[1] Most notably, the protocol amends the Treaty to eliminate the capital gains tax exemption for Mauritian tax residents that own shares in Indian companies, and it introduces the limitation of benefits article, which limits the scope of Mauritian entities that may utilize the Treaty. The protocol was notified by the Indian government in the official *Gazette of India* on August 11, 2016 and entered into force in India on July 19, 2016.[2] The key aspects of the protocol are summarized below.

Elimination of the Capital Gains Tax Exemption for Shares Held in Indian Companies

- *Acquisitions on or after April 1, 2017*: The elimination of the capital gains tax exemption is centered around a cut-off date of April 1, 2017. Mauritian investors who acquire shares in Indian companies on or after April 1, 2017 are subject to a capital gains tax payable to the Indian government on any income received from the disposal of such shares.[3] The rate of tax may vary, depending on when the shares are sold, as described in the next paragraph.

- *Acquisitions on or after April 1, 2017 and disposed of by March 31, 2019:* Mauritian investors who acquire their shares on or after April 1, 2017, but who dispose of the shares prior to or on March 31, 2019 will pay capital gains tax at a discounted tax rate of 50 percent of the domestic rate in India, subject to a "limitations of benefits" clause (summarized next) in the Treaty. This two-year transitory period will expire on April 1, 2019; thus, investors who acquire their shares on or after April 1, 2017, but who dispose of the shares on or after April 1, 2019, will be taxed at the full capital gains domestic tax rate.

- *Acquisitions prior to April 1, 2017*: Mauritian investors who acquire shares in Indian companies before April 1, 2017 will be grandfathered under the protocol. Thus, these investors will continue to profit from the current capital gains tax exemption set forth in Article 13(4) of the Treaty.

- *The new limitation of benefits* (LOB) *clause*: The LOB clause is a new provision that sets forth the requirements for a Mauritian tax resident to avail itself of the 50 percent discounted tax rate explained above. A Mauritian tax resident cannot benefit from the discounted tax rate unless it passes the "main purpose test" and the "bona fide business test" under the LOB clause. Furthermore, a shell or a conduit company is **not** entitled to the 50 percent discounted tax rate. A Mauritian resident company is deemed to be a shell or a conduit company if its total expenditure on operations in

Mauritius is less than 2.7 million INR and 1.5 million MUR (approximately 40,000 USD), in the 12 months prior to the disposal of the shares.

Interest Income Arising in India Earned by Mauritian Residents

Under the prior provisions of the Treaty, there were no concessional provisions with respect to interest income. As a result, a Mauritian resident was potentially liable for Indian withholding tax rates on interest income earned from debt claims issued by Indian borrowers for up to 40 percent. Under the protocol, for extensions of credit made after March 31, 2017, the withholding tax rate will be capped at 7.5 percent.

Mauritius as a Source of Foreign Direct Investment into India and Indian Tax Law

Over the last few decades, Mauritius has been a tremendous source of foreign direct investment (FDI) into India, owing in large part to the capital gains tax exemption. Mauritius has been the source of around 34 percent of all FDI inflows into India between 2000 and 2015. Additionally, approximately 20 percent of foreign portfolio assets in India come through Mauritius. Eliminating the capital gains tax exemption may drastically hinder the flow of FDI streaming into India through Mauritius.

Recenly, there have been a number of developments in Indian domestic tax law. On May 14, 2016, the Finance Act 2016 was passed by the Indian Parliament.[4] Additionally, the Indian Central Board of Direct Taxes (CBDT) also issued circular no. 6/2016, dated February 29, 2016 (the Circular),[5] and follow-up letter no. F.No.225/12/2016/ITA.II, dated May 2, 2016 (the CBDT Letter).[6] Under the Circular, with respect to **listed** shares and securities held for a period of more than 12 months, if the taxpayer wishes to treat the income from the transfer as a capital gain, he may do so, and this election will be binding for subsequent assessment years.[7] There is currently no tax on capital gains for the sale of listed shares and securities after a holding period of 12 months on a recognized stock exchange, but, listed shares and securities sold before a 12-month holding period are subject to a short-term capital gains tax rate of 15 percent.

Under the Finance Act, **unlisted** shares held for 24 months or less will be treated as a short-term capital asset, to take effect from April 1, 2017 onwards; thus, any income on the sale of unlisted shares held for more than 24 months will be taxed at the long-term capital gains tax rate. The current long-term capital gains tax rate on sales of unlisted shares is 20 percent, while the short-term capital gains tax rate on sales of unlisted shares is 15 percent.

What Are the Implications for U.S. FDI into India?

Elimination of the capital gains tax exemption in the Treaty will primarily affect listed shares that are held for a short-term period (*i.e.*, less than 12 months) and any unlisted shares, such as investments in subsidiaries of U.S. operating companies. Although the short-term gain on listed securities owned through Mauritius that are acquired between April 1, 2017 through March 31, 2019 will be taxed at the maximum rate of 7.5 percent, by April 2019, investors such as hedge funds and other short-term portfolio investors that commonly use Mauritius as a gateway to invest into listed securities in India will be subject to the short-term capital gains tax rate of 15 percent.

U.S. investors who seek to invest in listed securities in India and use the "Mauritius route" may want to consider making very short-term capital inflows into India in order to take advantage of the remaining time for the capital gains tax exemption, which ends effectively April 1, 2017.

Additionally, the 7.5 percent withholding tax rate on interest income under the Treaty is much lower than the rates set forth in India's counterpart treaties with countries such as Singapore and the Netherlands, which may incentivize U.S. investors to consider creating Mauritian holding companies that fund their Indian subsidiary companies through debt securities.

A question arises as to which investments are encompassed within the definition of "shares," thereby determining the extent of India's tax rights with respect to the disposition of such investments. Certain experts and commentators have posited that securities such as convertible and nonconvertible debentures and other debt instruments do not fall within the definition of "shares" and thus should continue to enjoy the capital gains tax exemption. However, there continue to remain some open issues with respect to the foregoing. For instance, what is the tax treatment in a situation where a Mauritian resident acquires a convertible debenture in an Indian company prior to April 1, 2017, but converts the debt into equity shares after April 1, 2017 and subsequently sells the converted shares? Are the converted equity shares exempt from capital gains tax and covered under the Treaty's grandfathering clause, or will they be subject to capital gains tax in India? The answer to this question is somewhat ambiguous, and it depends on how such a situation is analyzed in the released protocol, as well as the effect of Rule 8AA of the Income-Tax Rules 1962, which explains what the holding periods should be for unconverted debenture instruments and the related converted shares.

Ambiguity also arises in a situation where shares transferred after April 1, 2017 are directly connected to shares that were acquired prior to April 1, 2017. A special panel composed of different officials from agencies such as the Securities and Exchange Board of India and the CBDT has identified a few such situations where open questions still remain:

- *Merger*: An investor buys shares in Company A before April 1, 2017. After April 1, 2017, Company A merges with Company B, and the investor receives shares of Company B as part of the merger transaction and a share-exchange scheme. The investor subsequently sells his Company B shares five years later. Although the investor acquired Company B's shares after April 1, 2017, such shares were directly connected to the merger and the share exchange with Company A occurring prior to this cut-off date. Thus, is the investor exempt from capital gains tax on the sale of Company B's shares?

- *Bonus Issuances*: Bonus shares that were issued after April 1, 2017 are sold, but they are directly related to shares that were acquired or issued prior to the cut-off date. Is the transfer of the bonus shares subject to capital gains tax?[8]

The special committee is set to provide recommendations to the Finance Ministry by September 2016, so it remains to be seen how and to what extent these open issues will be further clarified.

The recent amendments to the Treaty may certainly cause some uncertainty and anxiety for U.S. investors as they consider how these changes will impact business, income, profitability and the benefits or drawbacks of investing in India through Mauritius. However, certain features of the amendments, such as the grandfathering provision embedded into the capital gains tax provision and the fixed withholding tax rate for interest income provide U.S. investors with some added time to reconsider their investment vehicles and adapt their investment strategies to make these strategies tax efficient and profitable for the Indian financial climate.

Endnotes

1 http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/468/Press-release-Indo-Mauritius-10-05-2016.pdf.

2 http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/511/PRESS-RELEASE-Indo-Maritius-Protocol-29-08-2016.pdf.

3 Note that long-term capital gains realized from the disposition of shares in listed companies are exempt from the capital gains tax under Indian domestic law.

4 http://www.cbec.gov.in/resources//htdocs-cbec/fin-act2016.pdf.

5 http://www.incometaxindia.gov.in/communications/circular/circular-no-6.pdf.

6 http://www.incometaxindia.gov.in/Lists/Latest%20News/Attachments/30/Consistency-in-taxability-of-income-loss-arising-1961-09-05-2016.pdf.

7 http://www.incometaxindia.gov.in/communications/circular/circular-no-6.pdf; http://www.ilntoday.com/2016/06/clarification-by-cbdt-on-taxability-of-income-arising-out-of-transfer-of-shares/.

8 http://economictimes.indiatimes.com/news/economy/finance/panel-on-dtaa-with-mauritius-spots-tax-ambiguity/articleshow/53370712.cms.

Appraisal Arbitrage: Heads I Win, Tails You Lose

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Delaware state courts have seen a rise in appraisal petitions filed by shareholders dissenting from mergers, with 34 actions filed in the first half of 2016, compared to 16 in all of 2012, according to a recent *Wall Street Journal* article.

Much of the rise in appraisal petitions is attributable to "appraisal arbitrage," a strategy where investors, primarily hedge funds, invest in companies after a merger announcement to obtain returns through an appraisal proceeding rather than through the merger itself.

In Delaware appraisals, shareholders receive the fair value of their shares, as determined by the court, rather than the price offered in the merger, **plus** interest at a rate of 5 percent over the Federal Reserve discount rate. This relatively high interest rate encourages appraisal arbitrage, driving more than 45 percent of petitions filed and accounting for 60 percent of returns in Delaware appraisals from 2000 to 2014, according to a recent study by Wei Jiang, Tai Li, Danqing Mei and Randall Thomas.

Attempt to Curb Appraisal Arbitrage

Two amendments to Section 262, effective August 1, may discourage some appraisal petitions, but likely will not be enough to reduce appraisal arbitrage.

The first amendment requires, with some exceptions, that the total number of shares entitled to appraisal exceed 1 percent of the outstanding shares eligible or $1 million in value. Yet, the amendment fails to address the high statutory interest, limiting its impact on appraisal arbitrage.

The second amendment allows companies to prepay shareholders before the fair value determination. This eliminates interest payable on the difference between the fair value and the cash prepayment, reducing potential returns for arbitrageurs. However, it also sets a floor on the investors downside and gives them access to immediate cash.

Guidance from the Dell Appraisal Decision

Unlike the amendments, the recent Dell appraisal case provides a roadmap for investors on where appraisals may be most effective.

In particular, the decision, which valued Dell shares around 30 percent more than the amount paid in the 2012 management buyout at issue, highlights three reasons why the merger price in management or leveraged buyouts may not reflect fair value:

1. Leverage-based valuation models focus on what buyers are willing to pay, not going concern value.

2. Buyouts often take advantage of valuation gaps between market price and the long-term value of the company.

3. Structural issues in buyouts (e.g., information asymmetry, restrictive go-shop provisions) may inhibit price competition post-signing, emphasizing the need for robust pre-signing competition.

Investors likely will continue to challenge merger strategies built on the teachings of Dell, hoping that a court will find the target similarly undervalued. Rather than be eliminated by the amendments to Section 262, appraisal arbitrage can be expected to remain a trend in 2016, especially in mergers involving management buyouts or leveraged buyouts.

As a side note, one of the largest opponents of the Dell transaction, T. Rowe Price, lost out on two counts. First, the automated voting protocols voted for the transaction when the fund thought it had voted no (a necessary predicate to appraisal rights). Second, it mistakenly waited two years to receive the merger consideration, costing its investors $190 million, without interest, that the fund says it will repay.

The European Commission Formally Adopts the Privacy Shield

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THE PRIVACY SHIELD HEIGHTENS THE LEVEL OF SCRUTINY AND THE BURDEN ON ORGANIZATIONS THAT VOLUNTARILY SELF-CERTIFY.

On October 6, 2015, the Court of Justice of the European Union invalidated the European Commission's (the Commission's) Safe Harbor Decision, which (previously) allowed for U.S.-based companies to transfer personal data of European Union (EU) citizens from the EU to the United States if they complied with certain principles. "Personal data" is a broad term encompassing all data through which a unique person can be identified or is identifiable. Pepper previously reported on this invalidation,[1] and U.S. companies waited with bated breath to see what would take the Safe Harbor Decision's place. On February 2, 2016, the U.S. Department of Commerce (the Commerce Department) and the Commission announced the new EU-U.S. Privacy Shield (Privacy Shield), which Pepper also reported.[2] Finally, Pepper can now report on the Commission's July 12, 2016 formal adoption of the Privacy Shield.

Overview

On the EU side, the Commission and the European Data Protection Authorities (DPAs) will administer the Privacy Shield. The Commerce Department, the Federal Trade Commission (FTC) and the Department of Transportation (DOT) will monitor and enforce the Privacy Shield on the U.S. side, though other subject-matter regulators may subsequently express interest. The Privacy Shield allows for personal data of EU citizens to flow from entities located in EU member states and European Economic Area member countries to organizations in the United States. By implementing the Privacy Shield, the Commission has deemed that the transfer of data under the Privacy Shield provides an "adequate level of protection for personal data transferred to the U.S." (Adequacy).

The Privacy Shield consists of several components. The first is the **Privacy Shield Principles** (the Principles), which is a code of conduct governing how U.S.-based organizations that make an enforceable commitment to abide by the Principles may handle personal data transferred from the EU to the United States (EU-U.S. transfers). Second, the Privacy Shield provides for **Oversight and Enforcement**, which outlines how U.S. governmental agencies will administer and enforce the Privacy Shield. Third, the Privacy Shield creates an **Ombudsperson Mechanism** to facilitate EU-U.S. transfers relating to national security. Fourth and finally, the Privacy Shield puts in place **Safeguards and Limitations** that require an annual review of Adequacy, including how national security and law enforcement agencies access and use data.

Notably, while the Privacy Shield includes many new, first-time requirements for law enforcement and national security agencies (many of which may implicate the commercial sector), this article focuses on the Principles, which are most applicable to companies seeking Privacy Shield self-certification.

Privacy Shield Principles

While adherence to the Principles is voluntary, U.S. organizations seeking self-certification subject themselves to monitoring and enforcement from the Commerce Department, FTC and/or DOT for failure to comply. There are seven requirements under the Principles.[3] These principles have long been the basis for EU data protection.

1. **Notice:** Organizations must provide data subjects with information concerning how their data will be processed, for example, the type of data collected, the purpose of processing, etc. Organizations must also provide links to the Commerce Department's website regarding details on self-certification and the Privacy Shield List (the list of self-certifying entities).

2. **Data Integrity and Purpose Limitation:** Organizations must only use personal data for the limited purposes for which it was originally collected and/or authorized by the data subject. Organizations must also ensure that personal data is "reliable for its intended use, accurate, complete and current."

3. **Choice:** If the purpose of collection or use changes, the organization must give data subjects the right to opt out of continued use. In the case of sensitive data, organizations must obtain affirmative express consent (opt in) prior to use.

4. **Security:** Organizations must take "reasonable and appropriate security measures" to make sure personal data remains protected. Organizations must also contract with third parties that the organizations use for sub-processing to ensure that these third-party processors provide the same level of protection as provided under the Principles.

5. **Access:** Organizations must ensure that data subjects have the right to confirm whether an organization has a data subject's personal data and, if so, be able to access and correct the data for free or for a nonexcessive fee. Organizations may not deny access except under exceptional circumstances.

6. **Recourse, Enforcement and Liability:** Organizations must implement policies to ensure compliance with the Principles. Organizations must also annually recertify their compliance with the Principles and verify that their published privacy policies conform to the Principles. The latter can be achieved through self-assessment or by outside compliance reviews. Additionally, organizations must put in place redress mechanisms that allow the organizations to redress any complaints by data subjects. These new requirements are explored further below.

7. **Accountability for Onward Transfer:** Organizations must ensure that any onward transfer of personal data is only for "(i) limited and specified purposes, (ii) on the basis of a contract (or comparable arrangement within a corporate group) and (iii) only if that contract provides the same level of protection as the one guaranteed by the Principles." This requirement is even more explicit than the version under the Safe Harbor Decision.

Self-Certification

While self-certification is not available until August 1, 2016, organizations may begin to prepare for the process. Self-certification requires that an organization certify, on an annual basis, that the organization agrees to adhere to the Privacy Shield's requirements, including "notice, choice, access, and accountability for onward transfer."

In helping organizations prepare for self-certification, the Commerce Department has provided the following guidelines:

1. **Confirm your organization's eligibility to participate in the Privacy Shield.** Under the Commerce Department's current guidance, only organizations subject to the jurisdiction of the FTC or DOT may participate in the Privacy Shield. However, the number of subject-matter agencies may expand over time.

2. **Develop a Privacy Shield-compliant privacy policy statement.** To self-certify, an organization must ensure that its external privacy policy conforms to the Principles. The organization must also make specific reference to its Privacy Shield compliance and provide a link to the Commerce Department's Privacy Shield website. If the privacy policy is online, it must also link to the organization's independent recourse mechanism (IRM). The organization must also provide the Commerce Department with the web address of the privacy policy or a physical address where the public may view the privacy policy.

3. **Identify your organization's independent recourse mechanism.** While the first step should be for the organization itself to resolve complaints from data subjects, an organization must also provide an IRM that can investigate unresolved complaints at no cost to the data subject. The IRM can utilize private-sector dispute resolution programs, such as the Council of Better Business Bureaus, JAMS or TRUSTe. Alternatively, the organization may choose as its IRM to cooperate and comply with DPAs for all data types. But, for human resource-related data, cooperation and compliance with DPAs is mandatory. Moreover, cooperation with the Commerce Department or the FTC is mandatory, independent of data type. The organization must also submit to binding arbitration by the Privacy Shield Panel for any disputes unresolved by its IRM.

4. **Ensure your organization's verification mechanism is in place.** An organization must be able to verify compliance with the Privacy Shield's requirements. An organization can conduct a self-assessment or third-party assessment to verify compliance. An organization must ensure that, if it chooses or is no longer able to be compliant with the Privacy Shield, it notifies the Commerce Department and it continues to protect, destroy or return personal data it already has received.

5. **Designate a contact within your organization regarding the Privacy Shield.** An organization must provide a contact for handling inquiries regarding the Privacy Shield. An appropriate designee is usually a corporate officer, such as a Chief Privacy Officer. An organization must respond to a data subject within 45 days of receiving a complaint.

Pepper Point

From a commercial sector aspect, the Privacy Shield, its Principles and self-certification embody many of the previous requirements under the Safe Harbor Decision. However, the Privacy Shield heightens the level of scrutiny and the burden on organizations that voluntarily self-certify. It makes any subsequent noncompliance subject to federal agency enforcement, including Section 5 of the Federal Trade Commission Act. It also requires organizations to provide data subjects with the ability to seek redress for their complaints.

Furthermore, by annually requiring self-certification renewal and periodic verifications, the Privacy Shield increases an organization's due diligence obligation for assessing whether its privacy program adequately protects EU citizens' personal data. Additionally, it explicitly requires self-certifying organizations to impute the Principles to third-party processors by making them contractually required to provide the same level of privacy and security to personal data transmitted to them. Thus, even if an organization has not self-certified, it may still be required to adhere to the Principles if it is a vendor to a self-certifying organization. As organizations start to self-certify and the Privacy Shield progresses, Pepper will continue to track these developments.

Endnotes

1. *See* Sharon R. Klein & William M. Taylor, EU Court of Justice: Safe Harbor Decision Permitting EU-U.S. Personal Data Transfers is Invalid, *Pepper Hamilton Client Alert* (Oct. 6, 2015), *available at* http://www.pepperlaw.com/publications/eu-court-of-justice-safe-harbor-decision-permitting-eu-us-personal-data-transfers-is-invalid-2015-10-06/.

2. *See* Sharon R. Klein & Alex C. Nisenbaum, U.S. and EU Authorities Announce New Privacy Shield for Data Transfers, *Pepper Hamilton Client Alert* (Feb. 4, 2016), *available at* http://www.pepperlaw.com/publications/us-and-eu-authorities-announce-new-privacy-shield-for-data-transfers-2016-02-04/).

3. Notably, EU member state laws supersede the Principles regarding any collection, use and processing of human resource data collected in the employer-employee context. The Commerce Department has also provided Supplemental Principles for further guidance on implementation of the Principles.

PEPPER HAMILTON EXPANDS TECHNOLOGY GROUP

Leveraging what the firm has already been doing for decades in the technology space, Pepper Hamilton announced the expansion of its Technology Group through a new committee and leadership. The multidisciplinary group comprises lawyers from across the country who understand the nuanced issues faced by businesses, and who are able to offer practical, tailored guidance on technology-related matters. Clients of the Technology Group span a variety of industries and include technology vendors (*e.g.*, software licensors, hardware manufacturers, technology service providers) and users (software licensees, hardware purchasers, purchasers of technology services) at all stages of the technology lifecycle.

Attorneys within the Technology Group have represented many high-profile clients and technology matters, including the iGATE/Capgemini merger for $4 billion and representing Infor in its global strategic acquisition program to continue growth as the 3rd largest enterprise software company.

Joe Guagliardo, vice chair of the Technology Group said "Pepper has been handling major technology-related matters from the early days of mainframe technologies to the days before the Internet through today, including the latest developments in the Internet of Things (IoT) and blockchain technology."

For more information on the major areas of practice within the group, visit http://www.pepperlaw.com/capabilities/technology/.

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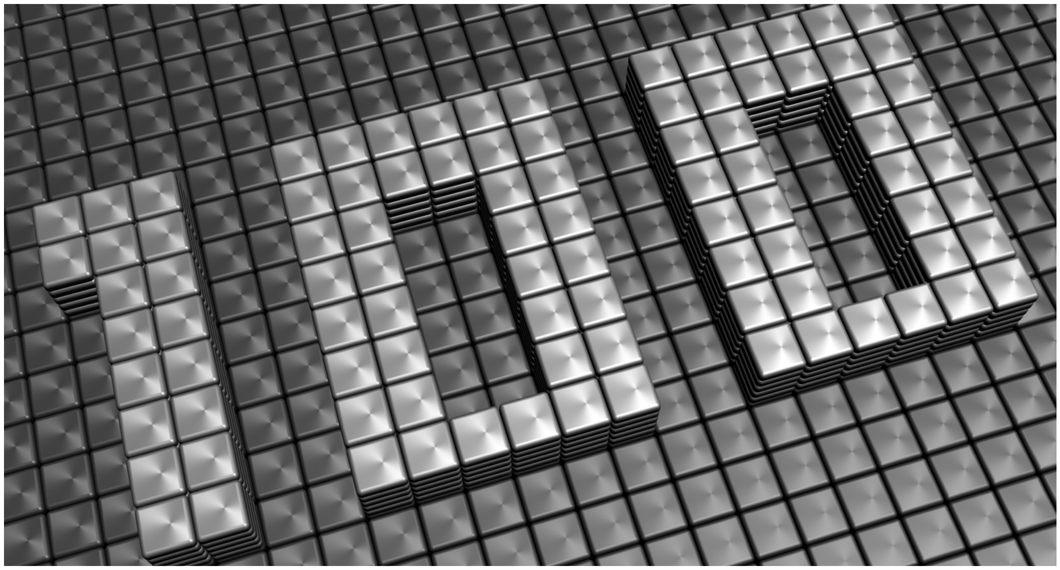
The 100-Day Program at the ITC



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IN LIGHT OF *AUDIO PROCESSING HARDWARE*, IT IS NOW CLEAR THAT, WITH RESPECT TO APPEALS OF ITC 100-DAY PROGRAM DETERMINATIONS, COMMISSION DETERMINATIONS AGAINST A COMPLAINANT ARE IMMEDIATELY APPEALABLE, WHILE DETERMINATIONS IN FAVOR OF THE COMPLAINANT ARE NOT.

The U.S. International Trade Commission (the Commission or ITC), an independent quasi-judicial federal agency, is well-known for the speed with which it adjudicates patent infringement claims.[1] On average, an evidentiary hearing is held within 8–10 months after the filing of a complaint. This compressed schedule, coupled with the broad discovery afforded in the ITC, often results in substantial legal expenses for the parties. In an attempt to conserve the resources of private parties and the Commission, the Commission implemented the 100-day pilot program, which, ironically, compresses the schedule even more with respect to one or more potentially case dispositive issues.

On June 24, 2013, the ITC issued a press release formally announcing the pilot program.[2] Under the program, the Commission, at institution,[3] can direct an administrative law judge (ALJ) presiding over a section 337 investigation to conduct expedited discovery and factfinding (including an early evidentiary hearing) on a potentially dispositive issue, such as the existence of a domestic industry,[4] importation[5] or standing. The ALJ is then required to issue an initial determination deciding the issue within 100 days of institution. Unless the Commission decides to review that determination within 30 days, it becomes the final determination of the Commission.[6] Under certain circumstances, the Commission's determination, as will be discussed below, may be appealable to the U.S. Court of Appeals for the Federal Circuit.

Recent Investigations

To date, three investigations have been subject to the pilot program. In the first investigation, *Certain Products Having Laminated Packaging, Laminated Packaging, and Components Thereof* ,[7] the Commission ordered the ALJ to determine whether the complainant, Lamina Packaging Innovations LLC, satisfied the economic prong of the domestic industry requirement. In the second investigation, *Certain Audio Processing Hardware and Software and Products Containing Same*,[8] the ALJ was ordered to determine whether the complainant, Andrea Electronics Corporation, had standing to assert the asserted patents. In the third investigation, *Certain Portable Electronic Devices and Components Thereof*,[9] which is currently pending, the ALJ was ordered to determine whether the asserted claims of the patent-in-suit recite patentable subject matter under 35 U.S.C. § 101, a defense that has gained prominence in light of the Supreme Court's decision in *Alice Corp. v. CLS Bank International*.[10]

In *Laminated Packaging*, the investigation was terminated based on a finding of no domestic industry; while in *Audio Processing Hardware*, it was allowed to proceed because the complainant, Andrea Electronics, represented by Pepper Hamilton, was found to have standing to bring its claim. The 100-day evidentiary hearing in *Portable Electronic Devices* occurred in early July, with an initial determination on the preliminary issue due on August 19, 2016.[11]

Appeals of 100-Day Determinations

Because the 100-day proceeding was introduced as a pilot program to test its efficacy, rather than through formal rule making, there were a number of unanswered procedural questions at the program's inception. One such question related to the timing of a Federal Circuit appeal of a Commission determination issued in a 100-day proceeding. This question was answered in *Audio Processing Hardware*.[12]

In *Audio Processing Hardware*, Pepper Hamilton attorneys successfully argued that Andrea Electronics had standing to bring its complaint. The ALJ issued an initial determination to that effect and ordered the investigation to proceed.[13] The respondents requested Commission review of the initial determination, which Andrea Electronics opposed. The Commission determined not to review that decision, making the ALJ's initial determination the final determination of the Commission with respect to standing.[14]

Although the investigation was set to move forward, certain respondents,[15] having lost on the standing issue at the ITC, filed a petition for review of the Commission's determination with the Federal Circuit.[16] Believing that the respondents' appeal was premature, the Commission, as appellee,[17] and Andrea Electronics, as an intervenor, jointly filed a motion to dismiss the respondents' petition for review, arguing that the Federal Circuit lacked jurisdiction to hear the appeal.[18]

Under 28 U.S.C. § 1295(a)(6), the Federal Circuit has the authority to review "the *final determinations* of the United States International Trade Commission relating to unfair practices in import trade, made under section 337 of the Tariff Act of 1930 (19 U.S.C. 1337)" (emphasis added). Pepper, along with the ITC attorneys, argued that the Commission's 100-day determination on standing was not a reviewable final determination under 28 U.S.C. § 1295(a)(6). Specifically, it was argued that the final determinations referenced in 28 U.S.C. § 1295(a)(6) are defined in 19 U.S.C. § 1337(c), which states in relevant part:

> Any person adversely affected by a final determination of the Commission under subsection (d), (e), (f), or (g) of this section may appeal such determination, within 60 days after the determination becomes final, to the United States Court of Appeals for the Federal Circuit for review in accordance with chapter 7 of Title 5.[19]

Subsections (d), (e), (f) and (g) respectively provide for permanent exclusion orders, temporary relief orders, cease and desist orders and orders granting relief when a respondent defaults.[20] Because the Commission's determination that Andrea Electronics has standing was not an order issued under subsections (d) – (g), the ITC and Andrea Electronics argued that the Commission determination was not the type of "final determination" the Federal Circuit is allowed to review under 28 U.S.C. § 1295(a)(6).[21] The Federal Circuit agreed.

In rendering its decision, the Federal Circuit found that the Commission had not made a final administrative decision on the merits but, instead, had only made a decision on the preliminary question of standing, which merely allowed the case to move forward.[22]

Accordingly, the court held that the Commission's determination was not a final determination under subsections (d), (e), (f) or (g) and therefore was "not reviewable until the Commission render[ed] a final appealable decision."[23]

Because Commission orders that have "the same operative effect, in terms of economic impact upon those terminated, as a final determination," are reviewable, the court also analyzed whether the Commission's standing decision was equivalent to a final determination.[24] The Federal Circuit found that it was not. In rendering its decision, the court focused on the fact that the Commission's determination did not terminate the investigation and that proceedings to determine whether Andrea Electronics was entitled to any relief were ongoing.[25] As part of its analysis, the court commented that, if the Commission had found no standing (which would have terminated the investigation), then that determination would have been immediately appealable.

Implications

As the 100-day program will likely become a permanent fixture at the ITC, practitioners will be analyzing those investigations subject to a 100-day order to better understand the metes and bounds of the proceedings. For example, in light of *Audio Processing Hardware*, it is now clear that, with respect to appeals of ITC 100-day program determinations, Commission determinations against a complainant are immediately appealable, while determinations in favor of the complainant are not. Because so few cases have gone through the expedited proceeding, each investigation that is subject to it can significantly shape the law and forthcoming rules governing the 100-day program. As such, the pending 994 Investigation is one that will be closely watched by members of the ITC bar.

Endnotes

1. The ITC investigates unfair practices in import trade, which includes, among other things, the importation into the United States, the sale for importation, and the sale after importation within the United States of articles that infringe a valid and enforceable U.S. patent, trademark or copyright. 19 U.S.C. § 1337(a)(1)(B) and (C).

2. Press Release, Faster Investigation Resolution, Lower Litigation Costs Are Goals of USITC Section 337 Pilot Program (June 24, 2013), *available at* https://www.usitc.gov/press_room/news_release/2013/er0624ll1.htm.

3. In a section 337 investigation, after a complainant files a complaint, the Commission has 30 days in which to decide if it will institute the requested investigation.

4. Section 337 was enacted in order to protect U.S. industry from foreign unfair competition. Thus, section 337 requires a complainant to show the existence of an industry in the United States relating in some manner to articles protected by the intellectual property at issue.

5. Unless a complainant can establish at least one instance of an accused product being imported into the United States, being sold for importation or being sold after importation in the United States, the Commission lacks jurisdiction to conduct a section 337 investigation.

6. After an ALJ issues an initial determination, it is reviewed by the Commission, which is composed of six commissioners. On review, the Commission can affirm, reverse, modify, set aside or remand for further proceedings. The timing for Commission review depends on the procedural posture under which the initial determination was issued. In the case of an initial determination issued under the pilot program, the parties have five days to request review by the Commission, and the Commission has 30 days to decide whether to grant such review. The Commission may also decide to review the initial determination *sua sponte*.

7. Inv. No. 337-TA-874 (U.S.I.T.C.) [*hereinafter Laminated Packaging*].

8. Inv. No. 337-TA-949 (U.S.I.T.C.) [*hereinafter Audio Processing Hardware*].

9. Inv. No 337-TA-994 (U.S.I.T.C.) [*hereinafter Portable Electronic Devices*].

10. 134 S. Ct. 2347 (2014).

11. *Portable Electronic Devices,* Order No. 7: Amended Procedural Schedule (May 26, 2016), Doc. ID No. 582284.

12. In *Laminated Packaging*, the ALJ initially determined that Lamina did not satisfy the economic prong of the domestic industry requirement. *Laminated Packaging*, Order No. 15: Initial Determination on the Economic Prong of the Domestic Industry

Requirement (July 5, 2013), Doc. ID No. 513333. The Commission reviewed and upheld the ALJ's initial determination. *Laminated Packaging*, Commission Op. (Sept. 3, 2013), Doc. ID No. 517360. As a result, the investigation was terminated. After termination, Lamina filed a petition for review at the Federal Circuit. Petition for Review and Notice of Appeal, *Lamina Packaging Innovations, LLC v. ITC.*, No. 2014-1013 (Fed. Cir. Oct. 8, 2013), Doc. No. 1-2. However, before the Federal Circuit could issue a decision on the request, Lamina withdrew its petition due to settlement. Stipulation of Withdrawal, *Lamina Packaging Innovations*, No. 2014-1013 (Fed. Cir. Feb. 24, 2014), Doc. No. 68; *id.*, (Fed. Cir. Mar. 7, 2014), Doc. No. 69. Because the court did not have an opportunity to rule on Lamina's request, the question of whether the Federal Circuit had jurisdiction to review a Commission decision issued under the 100-day program went unanswered.

13. *Audio Processing*, Order No. 8: Initial Determination Finding Complainant Andrea Electronics Has Standing to Assert in this Investigation U.S. Patent Nos. 5,825,898; 6,483,923; 6,049,607; 6,363,345; 6,377,637 (June 11, 2015), Doc. ID No. 560765.

14. *Audio Processing*, Notice of Commission Determination Not to Review an Initial Determination Finding that Complainant Andrea Electronics Corp. Has Standing and to Deny Respondents' Motion for Oral Argument (July 13, 2015), Doc. ID No. 560585.

15. The respondents included Hewlett-Packard Company; Dell, Inc.; Acer, Inc.; Acer America Corp.; ASUSTeK Computer, Inc.; ASUS Computer International; Lenovo Holding Co., Inc.; Lenovo (United States) Inc.; Toshiba Corp.; and Toshiba America Information Systems, Inc.

16. Petition for Review, *Hewlett-Packard . v. ITC.*, No. 2015-1912 (Fed. Cir. Aug. 11, 2015), Doc. No. 1-2.

17. When a Commission determination is appealed to the Federal Circuit, the Commission, represented through its general counsel's office, is the appellee. The opposing private party usually joins as an intervenor in the appeal.

18. Joint Motion to Dismiss the Appeal, *Hewlett-Packard*, No. 2015-1912 (Fed. Cir. Aug. 18, 2015), Doc. No. 26.

19. *Id.* at 3–5.

20. 19 U.S.C. § 1337.

21. Joint Motion to Dismiss the Appeal at 3-5, *Hewlett-Packard*, No. 2015-1912, (Fed. Cir. Aug. 18, 2015), Doc. No. 26.

22. *Hewlett-Packard*, No. 2015-1912, slip op. at 3–4 (Fed. Cir. Sep. 29, 2015), Doc. No. 66.

23. *Id.* at 3.

24. *Id.* at 4 (quoting *Broadcom Corp. v. ITC*, 542 F.3d 894, 896 (Fed. Cir. 2008)).

25. *Id.* at 4-5. The Federal Circuit distinguished the following cases cited by the respondents in support of their "same operative effects" argument: *Broadcomm Corp. v. ITC*, 542 F.3d 894, 896 (Fed. Cir. 2008); *InterDigital Commc'ns, LLC v. ITC*, 718 F.3d 1336 (Fed. Cir. 2013), *vacated on other grounds*, 134 S. Ct. 1876 (2014); *Farrel Corp. v. ITC*, 949 F. 2d 1147 (Fed. Cir. 1991).

Your Next IPO Could Be on the Blockchain

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DELAWARE'S CORPORATE LAW BLOCKCHAIN INITIATIVE INCLUDES A NEW CLASS OF "DISTRIBUTED LEDGER SHARES" AND PROMISES TO LOWER TRANSACTIONAL COSTS, SPEED UP AND AUTOMATE MANUAL PROCESSES, AND REDUCE FRAUD.

The public and private sectors are embracing blockchain technology (aka distributed ledger technology), the peer-to-peer technology underlying the cryptocurrency Bitcoin. The technology has broad utility across many different use cases beyond cryptocurrencies as it offers a more efficient, secure and transparent mechanism for storing, tracking, trading and verifying assets and information. Generally speaking, a blockchain is a distributed database of digital transactions that are verified by participants in the blockchain network and recorded in chronological and linear order. Soon, you may even find that your next private equity transaction or initial public offering involves equity interests traded on the blockchain.

At the end of last year, NASDAQ issued private shares of Chain (chain.com) on its blockchain-based Linq trading platform, and Overstock.com recently announced it will issue new publicly traded common shares on its t0.com blockchain platform. Now, the state of Delaware has announced steps to embrace blockchain technology in corporate law and transactions.

On May 2, Delaware Governor Jack Markell launched the state's blockchain initiative. This initiative promises to lower transactional costs, speed up and automate manual processes, and reduce fraud — the oft-cited value propositions for blockchain implementations across many industries. One of the four facets of the Delaware initiative is to enable the authorization of "distributed ledger shares" by Delaware corporations — essentially public shares to be issued and traded entirely on the blockchain. In the near future, distributed ledger share IPOs could be a reality in Delaware, which is already the home of 85 percent of U.S. initial public offerings.

The four facets of the Delaware blockchain initiative include the following:

- observing and working with the industry (rather than immediately regulating) to ensure that Delaware's regulatory environment is welcoming and enabling for blockchain companies and technologies

- working with the corporate legal community to assess the need for potential clarifications to Delaware corporate law to enable the authorization of distributed ledger shares

- naming an ombudsperson to welcome companies in the industry to Delaware

- committing to the use of blockchain technology to store state archival records on a distributed ledger, through a partnership with distributed ledger and smart securities startup Symbiont (http://symbiont.io/).

Delaware's progressive blockchain initiative is not surprising given that the state is the corporate home for many startup and venture capital-backed businesses as well as 66 percent of *Fortune* 500 companies. Although other states are considering similar blockchain initiatives, Delaware appears to be the early adopter and is preparing a regulatory and legal environment to foster blockchain technology innovation and encourage blockchain companies to locate in the state. The legal community should follow these developments, because the next IPO could be on the blockchain.

For a background on blockchain technology and its potential implications, read our previous alert available at http://www.pepperlaw.com/publications/blockchain-technology-preparing-for-disruption-like-its-the-1990s-2016-03-14/.