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Editors' Notes

Over the years, and following the general elections in 2019, the partnership between the United States and India has gone from strength to strength. U.S.-India bilateral trade surged to more than $142 billion in 2018, up 12.7 percent from $126 billion in 2017, according to a report from the U.S.-India Strategic Partnership Forum (USISPF). In a significant development, India became the 37th country to be accorded the Strategic Trade Authorization-1 (STA-1) status by the United States. This has paved the way for greater collaboration and high-technology product sales to New Delhi, particularly in the civil space and defense sectors.

The manufacturing sector has also received a boost through governmental initiatives such as Make in India, Skill India and Digital India. Reforms on the distribution front of the power sector have been implemented but need to accelerate to meaningfully turn around that sector. Most recently, August 2019 featured reforms aimed to make India a more attractive destination for foreign direct investment, including across the coal, contract manufacturing, retail (including online retail), and digital media sectors.

To consider India's economic outlook, Pepper Hamilton and USISPF hosted an event with Dharmakirti Joshi, chief economist of CRISIL – An S&P Global Company, in November 2018. Moderated by Soumya Sharma, the discussion focused on business topics pertaining to sectors experiencing and expecting growth. Mr. Joshi presented an optimistic outlook due to strong manufacturing, construction and infrastructure markets, despite challenges to India's economy overall, such as nonperforming assets and depreciation of the Indian rupee. Recent implementation of the Goods and Services Tax (GST) and the Insolvency and Bankruptcy Code (IBC) will be game changers over the next few years. The GST regime is helping create a common national market, and improving logistics efficiencies and formalization of the economy. And the IBC is speeding up resolution of bad loans,

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which should improve the corporate credit culture. A key variable for India's economic stability over the upcoming months, given both these domestic reforms and broader global trends toward protectionism, lies with oil prices.

In June 2019, the firm hosted Cyril Shroff, managing partner at Cyril Amarchand Mangaldas, for an interactive discussion chaired by Soumya Sharma and Matthew Adler, chair of Pepper's International and Domestic Arbitration Practice Group. The discussion centered around India's new data protection and data localization laws and regulatory proposals, as well as concerns emanating from India's deeply burdened debt market. In 2018, there were many changes in the legal and regulatory landscape of India, including the IBC and changes in insurance regulation. A landmark in India's regulatory landscape was the Supreme Court's order striking down a circular by India's central bank, RBI, requiring all defaults to be submitted to insolvency proceedings. Although the Court recognized the power of RBI to issue these directions, it ruled against a straightjacket approach.

An ever-evolving area of Indian law is arbitration, with 2018 being a particularly active year given India's hope to become a global hub for arbitration in the future. On the legislative side, the Arbitration and Conciliation (Amendment) Bill was introduced in the Indian Parliament in July 2018. In this issue, attorneys from Pepper's international and cross-border practices offer an overview of recent Indian judgments and legislation in the field of arbitration.

Business and legal reforms in 2018 helped India rise in global rankings for ease of doing business, making foreign investment more attractive. Total imports to the United States from India grew 11.9 percent to $54.4 billion in 2018, up from $5.8 billion in 2017, and up 111.7 percent from 2008. At the same time, the expanding Indian middle class is yielding increased domestic consumption of consumer goods and products. U.S. exports of goods, services and agricultural products to India rose to $60.4 billion in 2018 from $48.8 billion in 2017 — a massive increase since 2000, when the United States exported only $4.6 billion to India. The Indian government recently noted that, according to provisional figures, 2018 to 2019 has the highest total foreign direct investment ever received in India. Here at Pepper, we look forward to continued growth in 2019 — with the potential to reach $210 billion in bilateral trade by 2021. Pepper is devoted to serving U.S. clients investing and operating in India, and Indian clients investing or doing business in the United States.

Soumya Sharma
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EVENT

ACI's 2019 M&A, RWI and Transactional Insurance Conference, 'Cross-Border Transactions and the Global Reach of the M&A Market'

James D. Rosener

October 10-11, 2019
New York, NY

EVENT

The Art of Arbitration: Hot Topics and Practical Advice on International Construction and Commercial Arbitration

October 11, 2019
Philadelphia, PA

EVENT

Private Investment Fund Tax and Accounting Forum, 'International Tax Focus: GILTI, FDII, PFIC'

Annette M. Ahlers

Steven D. Bortnick

November 11-12, 2019
New York, NY

India as the Next Global Arbitration Hub – Mere Fantasy?

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The Problem: Litigation With No End in Sight[1]

India, the world's third largest economy[2], is undoubtedly a dominant force in global trade. But the country's regulatory regime, marred by long-winding red tape, has often been viewed as hostile. This view also extends to India's judicial machinery, which suffers from a mammoth backlog of more than 33 million pending cases before the various courts. The High Courts, which sit on appeals from trial courts, account for 4.3 million of these pending cases. The Supreme Court of India, the country's highest court, itself has 58,000 pending matters.[3] These factors have led to India's poor score on the World Bank's ease of doing business rankings for contract enforcement, where India comes in at number 163 out of 190 countries worldwide.[4]

Under these circumstances, commercial disputes are bound to get stuck for years before being resolved. Usually, a dispute starts its life in the district court and works its way up through appeal to the High Court and, ultimately, the Supreme Court after several years. But a way out of this grueling cycle of delays could be through arbitration and a judicial system that respects the sanctity of arbitral awards.

The Solution: A Strengthened Indian Arbitration Regime

The Indian Government, recognizing the popularity of arbitration as a dispute resolution mechanism, has provided a much-needed stimulus through several legislative initiatives, including the Arbitration and Conciliation (Amendment) Act of 2015. But a controversial Amendment Bill of 2018[5] could potentially dampen the progress made, with provisions that have been termed "retrograde" by legal scholars. With ever-changing laws, much is also left to how courts interpret them. This article provides an overview of the current law under the 2015 Amendment and outlines key facets of the 2018 Bill.

Setting the Stage: The 2015 Amendment's Impact

Reduced Judicial Interference Into Arbitral Awards

Today's Indian arbitration landscape features drastically reduced judicial interference in arbitral awards, adding certainty for parties and respect for their underlying agreements. The heyday of judicial interference arose under the 2003 *Saw Pipes* judgment of the Supreme Court[6], wherein the scope of "public policy" as a ground to set aside an arbitral award was widened — especially with regard to domestic arbitration — to such an extent that an award that violated any Indian statute would be refused recognition and enforcement. This meant that Indian courts could practically revisit the entire merits of a case and decide it as per Indian law, irrespective of the arbitration agreement between the parties. Parties' contract autonomy, the touchstone of arbitration, was left hollow.

More than a decade after *Saw Pipes*, the catastrophic judgment was remedied to a large extent by the Supreme Court in *Lal Mahal v. Progetto*[7]. The Lal Mahal Court limited the applicability of the "public policy" doctrine, eschewing "patent illegality" in foreign-seated arbitration. The Supreme Court clarified that section 48 of the Arbitration Act of 1996, which deals with enforcement of foreign awards, does not offer an opportunity for Indian courts to have a second look at a foreign arbitration award at the enforcement stage, or permit review of the award on the merits. Accordingly, the Court held that the meaning of the expression "public policy" under section 48 is limited only to fundamental policy of India, interests of India, and justice and morality.

The next year, the legislature codified the *Lal Mahal* Court's reduction in the scope of judicial interference based on public policy. The 2015 Amendment[8] states that the "public policy" doctrine is limited to the following:

- an award obtained by fraud or corruption
- an award that is in contravention of **fundamental policies of Indian law** (meaning the spirit of the law as opposed to the letter of the law)
- an award that is in conflict with basic notions of morality and justice.

Under the 2015 Amendment, this limited public policy doctrine applies not just to foreign-seated arbitration (under section 48) but also to domestic arbitration (under section 34).

The 2015 Amendment[9] further clarifies that Indian courts are precluded from reviewing the merits of the dispute while testing contravention of the fundamental policy of India. Under the Amendment, courts can no longer conduct a "patent illegality" analysis in international commercial arbitration cases, and, even for domestic awards, it was clarified that mere erroneous application of the law would not amount to patent illegality.[10]

As highlighted in Pepper's 2016 article,[11] the 2015 Amendment served as a legislative fix to disparate judicial decisions on recognition and enforcement of awards, with a view to streamline the arbitral process.

Another key feature of the 2015 Amendment was the elimination of automatic stays. Under the pre-2015 Amendment regime, there would be an automatic stay on the operation of an award once the aggrieved party filed a section 34 application to set the award aside. Section 36 of the 2015 Amendment did away with this distressing provision. Under the new regime, the aggrieved applicant is required to make a separate stay application, which is further conditioned on furnishing security fixed by the court's discretion.

By enacting the 2015 Amendment, arbitral tribunals were also brought on par with courts for grants of interim relief. The amended section 17 of the Arbitration Act allows parties to approach the tribunal for interim measures, thus limiting the role of the courts and saving the parties precious time.

Availability of the Indian Courts for Foreign Arbitration

Although the 2015 Amendment curbed judicial interference in domestic and foreign arbitral awards, it also expanded the availability of judicial remedies to the parties.

The Indian Arbitration Act is divided into four mutually exclusive domains: Part I of the Act deals with general provisions relating to domestic arbitration, while Part II deals with enforcement of foreign arbitral awards.[12] Before 2015, a crucial debate centered on the applicability of certain key sections in Part I to foreign-seated arbitration, which falls under Part II. Because the provision regarding interim measures (section 9) is contained only in Part I, is its application limited only to domestic arbitration, thereby barring interim relief for foreign-seated arbitration, even when the property is situated in India?

In its 2002 decision in *Bhatia International v. Bulk Trading SA*,[13] the Supreme Court held that, by default, Part I of the Act is also applicable to international commercial arbitration unless specifically excluded — seemingly solving the problem. However, a decade later in *BALCO v. Kaiser*,[14] the Supreme Court reversed course and concluded that Part I had no application to arbitrations that were seated outside India. While the *BALCO* view gave deference to the principle that the arbitral seat forms the gravitational center of the arbitration process, it deprived parties to foreign-seated arbitrations the ability to seek interim relief for property situated in India.

Under the 2015 Amendment, the proviso to section 2(2) (which deals with the applicability of the 1996 Act's Part I) gives parties of both foreign and domestic arbitration the right to approach Indian courts for interim measures (under section 9) or assistance for gathering evidence (under section 27), unless that right is specifically excluded by contract. The 2015 Act thereby broadened parties' right to interim judicial remedies in foreign arbitration cases, while respecting party autonomy.

Time Limit for Completion of Arbitration Proceedings

To remedy the slow pace of arbitration proceedings, section 29A, introduced by the 2015 Amendment, directs that all arbitrations must be completed within one year of the arbitral tribunal being constituted, *i.e.*, the period reckoned from the day the arbitrators enter reference. The period is further extendable by the mutual agreement of the parties by up to six months — adding up to a total of 18 months. A tribunal's failure to render an award within this time frame would allow the parties to approach the court for further extension, which it may grant on a showing of sufficient cause.

Unlike most provisions of the 2015 Amendment, section 29A was not posited in the recommendations of the 246th Law Commission Report. It also does not feature in the domestic legislation of other popular jurisdictions, and, as such, it is quite unique. While section 29A is well-intentioned and aims to streamline the arbitration process, it does take away from party autonomy and increases court interaction if the 18-month threshold is breached.

2018 Featured Key Judicial Decisions Interpreting the 2015 Amendment and a Proposed Bill to Strengthen Its Reforms

Although the changes introduced by the 2015 Amendment went a long away in making the arbitration process more robust and were lauded by stakeholders, the impact of the Amendment soon ran into the muddy waters of statutory interpretation.

Courts Resolved Timing Issues Concerning the Automatic Stay Process – but Under Threat From the 2018 Bill

As noted earlier, section 36 of the 2015 Amendment did away with the automatic stay provision. But section 26 of the 2015 Amendment states that the amended provisions apply only *"in relation* to arbitral proceedings" commenced after the cutoff date of October 23, 2015 but not *to arbitral proceedings* that commenced prior thereto (unless the parties agreed otherwise). This nuanced clause gave rise to an important timing question. If an arbitration commenced before the 2015 Amendment, but the set-aside proceeding began after the 2015 Amendment, would the 2015 Amendment's provision eliminating the automatic stay apply? This question was interpreted in different ways by the various High Courts, leading to a split.

The Supreme Court finally settled the issue in *BCCI v. Kochi Cricket*,[15] where it held that the amended provisions are prospective in nature but apply to both — arbitral proceedings *stricto sensu* and court proceedings that stem from them. Meaning therefore, the provisions of the Amendment, including the automatic stay, apply to court proceedings commenced after the cutoff date even if the arbitration commenced before the enforcement date.

What is troubling though is section 13 of the pending 2018 Amendment Bill. This provision states that, unless parties agree otherwise, the Amendment Act shall not apply to (a) arbitral proceedings that began before the commencement of the Amendment Act or (b) court proceedings arising out of, or in relation to, such arbitral proceedings, irrespective

of whether these court proceedings are commenced prior to or after the commencement of the Amendment Act of 2015. Thus, under the scheme proposed by the 2018 Bill, if for example, an arbitration commenced in 2014, and the set-aside proceedings commenced in 2019, the old and troublesome automatic stay would continue to apply.

This position runs counter to the decision in *Kochi Cricket*. In fact, the Court in that case took cognizance of this proposed amendment and remarked that, if passed, it would put the important amendments introduced by the Amendment Act "on the back burner" and frustrate the purpose of the principal Act.

Statutory Absurdity Made Logical: Proposed Limits on Tribunal's Interim Relief Power

Another key change proposed by the 2018 Amendment Bill concerns the provisions of section 17. The 2015 Amendment brought the Indian arbitral tribunal's power to grant interim relief up to par with that of a domestic court. But what it failed to account for is the fact that an arbitrator becomes *functus officio* upon rendering an award (save as to the limited purpose of rectifying errors in the award). Thus, under the 2015 Amendment, an arbitrator could continue exercising its power right up until enforcement of the award, which may be up to 12 years after the passage of the award. This could undoubtedly lead to a bizarre situation. To remedy this absurdity, the 2018 Amendment Bill enables the interim relief power of the arbitral tribunal only until the final award is passed. After the final award, the power to afford interim relief remains in the exclusive domain of the civil courts.

Proposed Timing Relaxation for Institutionalized International Arbitration

Yet another fix proposed by the 2018 Amendment Bill concerns the prescribed time limit for rendering an award. While the intention behind section 29A, which imposes a 12-month time limit for rendering an award was laudatory, many were critical because it sought to take a big bite out of party autonomy and failed to recognize the fact that some arbitration disputes are too complex to be subjected to such rigid timelines.

Section 6 of the 2018 Bill proposes to eliminate the strict time limit for international commercial arbitration. The bill instead recognizes party autonomy and rejects a one-size-fits-all approach, giving deference to the rules of various international arbitration organizations that already have strong case management systems in place.

Further, the language in section 29A of the 2015 Amendment placed the onus on the arbitrators to deliver an award within 12 months, whereas the 2018 Bill contemplates shared responsibility. It requires that the statement of claim and defense be filed within six months from the date the arbitrator receives notice of appointment.

The 2018 Bill and Foreign Arbitrators

On the downside, apart from the Supreme Court's disapproval on the issue of cutoff for applying the 2015 Amendment in *Kochi Cricket*, the 2018 Bill has also been met with sharp criticism for its provisions relating to foreign arbitrators.

The Eighth Schedule of the 2018 Bill states: "A person shall not be qualified to be an arbitrator unless he — (i) is an advocate within the meaning of the Advocates Act, 1961 having ten years of practice experience as an advocate," meaning an advocate registered to practice in India.

At least one international commentator has cautioned that this restrictive provision could "set back the cause of Indian arbitration by many years, perhaps a generation."[16] This echoes Justice Nariman's observation about the 2018 Bill in *Kochi Cricket*, although in a different context. Both jurists are united in their view — that the 2018 Bill is regressive and will set back the clock for Indian arbitration.

This provision of the 2018 Bill bucks the trend towards making Indian arbitration more robust and investor friendly. Foreign businesses would find it hard to agree to Indian arbitration if not allowed the opportunity to appoint an arbitrator from a jurisdiction of their choice. And if foreign parties are precluded from appointing an arbitrator of their choice, they may feel compelled to challenge these awards on the grounds of independence and impartiality. Thus, this mode of zealous protectionism may actually hamper Indian interests.

Outlook for 2019 — India as a Global Hub?

The current government of India has a very bullish economic outlook, and this covers the field of arbitration as well. After all, a robust arbitration mechanism helps commerce by sidestepping, to a large extent, the lethargic pace of the Indian courts. "Ease of doing business" is the buzzword of the incumbent Modi government. To that end, the 2018 Amendment Bill contains provisions to strengthen institutional arbitration and provide greater autonomy. It calls for the establishment of the Arbitration Council of India — an

independent body for the regulation and promotion of institutionalized arbitration. It also provides for confidentiality by stating that all details of arbitral proceedings will be secret and disclosure will be warranted only for implementing the award.

The government wants to develop India as a global arbitration hub like Singapore or London. Through the New Delhi International Arbitration Centre Bill of 2018, with the stated objective of "creating an independent and autonomous regime for institutionalized arbitration . . . for the better management of arbitration so as to make it a hub for institutional arbitration," India wants to set up its own world-class international arbitration center. But there are still many hurdles that need to be overcome before that dream can be realized. Chief among these concerns is a closed legal market. Opening the window a little, the Supreme Court in *Bar Council of India v. AK Balaji*[17] interpreted the Advocates Act to hold that, while foreign lawyers are not allowed to set up offices or practice in India, they can act in international arbitrations in India on a "fly-in fly-out basis." This has offered limited respite to foreign arbitration practitioners.

Two other key concerns are the fear of corruption in Indian courts and judicial delays. As to delays, even if the arbitration itself is quick and efficient, international parties will not choose India as the seat of an international arbitration if they believe that set-aside proceedings will take an additional 10 years after the arbitration award. Parties will only select India as the seat if Indian courts demonstrate that set-aside petitions will be dealt with quickly and efficiently. As to fears of corruption, an important theme of the Modi government is weeding out this malaise in India. It is crucial to the success of international arbitrations seated in India that India has courts with a reputation for the highest levels of integrity at all levels. Otherwise, parties will not select India as the seat, and the New Delhi International Arbitration Centre will suffer.

Finally, Indian courts will have to demonstrate that they will faithfully implement the narrower standard of review of the 2015 Amendment, and not revert to the *Saw Pipes* days of full merits review. If parties believe that the Indian courts will sit as appellate courts over international arbitration awards, they will select alternative destinations as their seats. Here it is important to note that cities throughout the world are making similar efforts to become attractive as international arbitration destinations, so the competition will be stiff.

Conclusion: Indian Courts and Legislature Are Becoming Friendlier to Arbitration Each Year

Apart from a few bumps on the road, one can see a dramatic shift in Indian arbitration jurisprudence from the 2003 *Saw Pipes* judgment to today. More cases are now dispensed with in a timely manner (itself a big challenge), and courts are no longer zealously guarding their turf as the sole umpires in commercial disputes. Interference by courts has seen a sharp decline. The courts have consistently recognized the “seat” of arbitration as paramount and, on that basis, have refused to entertain applications to set aside foreign-seated awards.[18]

In sync with the pro-arbitration judicial trend, the Delhi High Court in *GMR Energy Ltd. v. Doosan Power*[19] held that that there is no prohibition on two Indian parties opting for foreign-seated arbitration, and doing so would not be against the public policy of India. The decision, however, has come under sharp criticism from commentators, and one will have to wait for the Supreme Court to decide on this contentious issue to get more clarity.[20]

On a separate note, the courts have also dispassionately enforced awards in favor of foreign parties that entail large remittances from India — again showing deference to the institution of arbitration. In both *Docomo*[21] and *Unitech*,[22] the Delhi High Court gave the green light to foreign parties for collection on their awards against losing Indian entities despite objections by India’s central bank, the Reserve Bank of India.

This trend of arbitration-friendly judgments continued with the Supreme Court in 2018. In *Cheran Properties Ltd. v. Kasturi & Sons Ltd.*,[23] the Supreme Court held that parties can directly approach the appropriate specialized forum vested with power to execute particular remedies granted in an arbitral award. In that case, when the award entailed a transfer of shares, the Supreme Court held that the award holder can directly approach the National Company Law Tribunal (the forum that handles share transfer cases) to effect the transfer and execute the award, thereby sidestepping the requirement to approach another court for sanctioning enforcement of the award. Under *Cheran*, the enforcement of an award can be initiated anywhere in the country where the decree can be executed, and there is no requirement of obtaining a transfer of the decree from the court that would have jurisdiction over the arbitral proceedings.

Indian courts have also been reluctant to entertain anti-arbitration injunctions — cases calling for a halt on arbitration proceedings. Maintaining the sanctity of the arbitration clause, the Delhi High Court in *UOI v. Khaitan Holdings*,[24] a case under the India-Mauri-

tius Bilateral Investment Treaty (BIT), held that interference by domestic courts in arbitral proceedings, especially those under the BIT, would be permissible only in “compelling circumstances” in “rare cases.” The Court, while refusing to grant a stay of arbitration proceedings, observed that judicial interference in arbitration-related matters could “lead to erosion of investor confidence and also dislodge the fundamental precincts on which BITs are based.”

Another positive development was the decision in *Shriram EPC Ltd. v. Rioglass Solar SA*,[25] wherein the Supreme Court held that the nonpayment of stamp duty (under the Indian Stamp Act of 1899) cannot come in the way of enforcing a foreign arbitral award in India. Further simplifying the requirements for a valid arbitration clause, the Supreme Court recently observed in *Caravel Shipping Services v. Premier Sea Foods Exim*[26] that the arbitration clause (in this case, contained in a bill of lading) does not even need to be signed; the only requirement is that it must be in writing.

Through a slew of these legislative initiatives and conducive judicial decisions, India has gotten a major jumpstart in its hopes of becoming an arbitration hub. But a lot remains to be done to gain the confidence of parties for India to become the destination of choice in arbitration agreements. A mature domestic arbitration bar, an open legal market and respect for party autonomy by the bench could go a long way in achieving this goal.

Endnotes

1 This article serves as an update to the Pepper US-India newsletter article, *THE LONG AND WINDING ROAD OF ARBITRATION IN INDIA: EXAMINING 20 YEARS OF THE INDIAN ARBITRATION AND CONCILIATION ACT OF 1996* (1/29/2016). https://www.pepperlaw.com/publications/the-long-and-winding-road-of-arbitration-in-india-2016-01-29/.

2 In PPP/GDP terms.

3 https://www.indiatoday.in/india/story/3-3-crore-backlog-cases-in-courts-pendency-figure-at-highest-cji-dipak-misra-1271752-2018-06-28.

4 https://www.business-standard.com/article/opinion/ease-of-doing-biz-enforcing-contracts-ibc-cases-key-challenges-for-india-118110400573_1.html.

5 The Arbitration and Conciliation (Amendment) Bill 2018 was passed by the lower house of the Indian Parliament (Lok Sabha) on August 10, 2018. It will need to be passed by the upper house (Rajya Sabha) before it receives presidential assent and becomes law.

6 *ONGC v. Saw Pipes,* (2003) 5 SCC 705.

7 (2014) 2 SCC 433.

8 Explanation 1 to S. 34(2)(b).

9 Explanation 2 to S. 34(2)(b).

10 S. 34(2A).

11 *Supra* note 1.

12 Parts III and IV contain provisions relating to conciliation and other supplementary provisions.

13 (2002) 4 SCC 105.

14 (2012) 9 SCC 552.

15 (2018) 6 SCC 287.

16 Full text of the former UK Attorney General Lord Goldsmith's keynote address at the 11th Annual International Conference of the Nani Palkhivala Arbitration Centre, https://globalarbitrationreview.com/digital_assets/af2f810d-8154-4222-871c-46f4aa2e5d0b/Essential-Rules-for-Counsel-in-Preparing-for-an-International-Commercial.._.pdf.

17 (2018) 5 SCC 379.

18 *See Sakuma Exports v. Louis Dreyfus* (2015) 5 SCC 656.

19 2017 (6) Arb LR 447 (Delhi).

20 The author is of the opinion that the decision in *GMR* was ill-conceived based on the following grounds:

(a) The *GMR* judgment relies heavily on the Madhya Pradesh High Court judgment in *Sasan Power Ltd. v. North American Coal Corp.*, 2015 SCC Online M.P. 7417. Both cases deal with a pre-2015 Amendment scenario. Section 2(1)(f) of the Arbitration Act, as it stood then, read "international commercial arbitration" as a dispute where at least one of the parties is (i) a person who is a foreign national or habitually resident outside India; (ii) a body corporate incorporated outside India; (iii) a **company** or association or body of individuals whose central management and controls are exercised outside India; (iv) a foreign government. So, under a literal interpretation, two companies incorporated in India could opt for international commercial arbitration if at least one of them was under foreign control — even if both were purely Indian entities as per statute. The 2015 Amendment dropped the word "company" and closed this route, thereby addressing the mischief of a corporate entity having dual "citizenship" — meaning a company now has to be foreign incorporated if it wants to opt for foreign-seated arbitration, irrespective of where it is controlled. *GMR* fails to address this mischief.

(b) Earlier, in *TDM Infrastructure Private Ltd. v. UE Development India Private Ltd.*, 2008 (14) SCC 271, the Supreme Court observed that arbitration between two Indian parties having Indian nationalities **cannot** be said to be an international commercial arbitration. The Delhi High Court in *GMR*, however, distinguished this judgment of the Supreme Court in *TDM Infrastructure* on the ground that this observation was only made for the purpose of section 11 of the Act (appointment of arbitrators) and cannot be relied on for any other purposes. This may not be the right approach.

21 *NTT Docomo v. TATA Sons Ltd.*, (2017) SCC OnLine Del 8078.

22 *Cruz City 1 Mauritius Holdings v. Unitech Ltd.*, (2017) 239 DLT 649.

23 2018 (5) SCJ 33.

24 CS (OS) 46/2019, I.As. 1235 and 1238/2019; *Union of India vs. Khaitan Holdings (Mauritius) Limited & Ors.* (29.01.2019 - DELHC) : MANU/DE/0271/2019.

25 2018 (8) SCJ 346.

26 2018 (14) SCALE 743.

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Mergers & Acquisitions 2019: USA Chapter

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Overview

2018 M&A Numbers

Following 2017's market decline, overall M&A volume trended in a positive direction in 2018. While the almost 20,000 transactions closed globally in 2018 did represent a 15 percent drop from the previous year, a record median deal size of $48.2 million more than made up the difference. The $3.6 trillion worth of transactions closed in 2018 is less than 2 percent off the all-time volume peak of 2016 and represents a significant rebound from the previous year's mark. Furthermore, enterprise value/earnings before interest, taxation, depreciation and amortisation (EV/EBITDA) multiples for all deals reached 12.3× in 2018, decreasing slightly year-over-year but remaining well above the 10-year median EV/EBITDA multiples of 10.9×.

The domestic M&A market was once again robust, with the overall value of transactions based in North America exceeding $2.0 trillion for the fourth year in a row. This volume level was aided by a large number of “mega-deals”: seven of the top 10 announced transactions for U.S. targets in 2018 were valued in excess of $30 billion. Indeed, the 10 largest transactions announced in 2018 accounted for approximately 23 percent of the overall value of domestic M&A activity. Average transaction size continued to increase as a whole, as transactions in excess of $1 billion constituted roughly 75 percent of the aggregate deal value of M&A activity while accounting for less than 10 percent of the number of total transactions. This activity was significantly driven by large-scale deals in the health care and technology sectors. The median transaction size in North America was $60 million, an $11 million increase from 2017.

In contrast to the robust domestic M&A market, there has been a substantial and continuous drop in deal volume representing inbound investment activity. Total deal volume for inbound M&A transactions involving U.S.-based targets dipped almost 20 percent last year from 2017’s already declining numbers. Macroeconomic deceleration and political tension both have a role to play. In particular, isolationist rhetoric and trade disputes may have dissuaded potential Chinese buyers from purchasing U.S.-based assets. Last year marked the second straight year of decreases in cross-border transactions with China: Chinese entities accounted for only 5.6 percent of acquirors of North American targets, down from a peak of 9.4 percent in 2016.

Notably, inbound investment levels from Canada and Europe have similarly declined. Negotiations surrounding the North American Free Trade Agreement (NAFTA) likely impacted Canadian investments, while the continued uncertainty over Brexit in the United Kingdom and much of the European Union has had a negative ripple effect on Europe. The relatively strong dollar value and equity markets that were high for much of the year have also served to make inbound U.S. acquisitions more expensive. Canada remains the leading nation for inbound M&A activity, followed by Japan and the United Kingdom, over the past 12 months, measured by the number of transactions as well as aggregate dollar value. Cumulatively, given these challenging headwinds, it is not surprising that foreign companies seem less willing to spend on North American acquisitions, with no significant signs of any shift in this trend over the short-term.

Dealmaking

Strategic vs. PE Dealmaking

Sponsor-backed M&A activity levels increased slightly in 2018 in absolute terms, but more meaningfully as a proportion of overall M&A activity. Last year, 29 percent of all transactions were closed by financial buyers, and the remaining 71 percent of all transactions were closed by strategic buyers, according to S&P Capital IQ Data. In 2017, only 13 percent of all transactions were closed by financial buyers, and 87 percent of all transactions were closed by strategic buyers. Of all 2018 transactions having U.S. buyers, 34 percent of the transactions were closed by U.S. financial buyers, and the remaining 66 percent were closed by U.S. strategic buyers. Strikingly, in 2017, these numbers stood at 9 percent and 91 percent, respectively.

This continued rise in prominence of PE- and VC-backed companies in proportion to the total M&A market has been one of the reasons for the increased volume in the market, despite the 15 percent drop in overall deals completed. As an example, the median leveraged buyout size in 2018 was approaching $140.0 million, nearly triple the median M&A deal size for both strategic and sponsor-led transactions. In 2018 alone, private equity firms in the United States consummated over 5,500 acquisitions and the number of U.S. private equity-backed companies stood at just under 8,000. This is dramatically higher than the approximately 1,500 private equity-backed companies existing in 2000.

The competition to deploy capital among private equity firms remains strong as there is a scarcity of quality assets. Political unrest and the spectre of a prolonged trade war continue to concern investors and they are responding by more carefully reviewing the potential for disruptions in upstream supply chains and downstream end-markets. New ultra-large infrastructure funds have been announced leading to expectations of large leveraged buyout transactions in the infrastructure space in the near-term. During the 2007–2009 downturn, sponsors looked for alternate ways to use surplus capital, including by acquiring minority stakes in companies challenged by liquidity issues. This pattern has undergone a resurgence in recent years; there are mounting examples of private equity firms developing or contemplating affiliated funds (The Riverside Company, Huron Capital and Balance Point Equity) specifically to invest in minority investments and other structured equity. More than $21 billion has been raised in 2018 by private equity firms for the purpose of minority investments, which is in addition to the record-high $23 billion that was raised in 2017 according to PitchBook data. These minority investments offer middle-market private equity firms a chance to differentiate themselves in a crowded market and present the company owners the option to maintain control of the business and to cash out at a later date.

Shareholder Activism and Hostile Bid Activity

In 2018, the number of activist campaigns against U.S.-based targets saw a slight increase. Of the 493 activist campaigns last year, 74 percent of the activist demands were board-related or related to other governance matters. Only 12 percent of the activist demands were related to M&A or breakup demands (pushing for M&A, opposing M&A or demanding spinoff/breakup). In addition to supporting the M&A market directly, this sort of activist involvement has encouraged companies to more aggressively engage in transaction discussions in order to preempt anticipated activist activity.

The number of unsolicited M&A bids rebounded in 2018, after seeing a substantial decline in 2017. According to Houlihan Lokey data, the largest hostile M&A bid was Comcast Corp.'s bid for Twenty-First Century Fox, Inc., an American multinational mass media corporation (valued at $77.5 billion; withdrawn July 19, 2018). The next three largest hostile bids in 2018 were: MGM Growth Properties LLC's bid for VICI Properties Inc., an experiential-asset real estate investment trust (valued at $11.8 billion; January 16, 2018); certain Nordstrom family members' bid for Nordstrom, Inc., a fashion specialty retailer in the United States (valued at $7.4 billion; March 5, 2018); and Gebr. Knauf KG's bid for USG Corp., the largest distributor of wallboard in the United States and the largest manufacturer of gypsum products in North America (valued at $6.1 billion; March 26, 2018).

Industry Sector Focus

In 2018, Information Technology (IT) and Industrials were the two sectors with the most M&A activity, as determined by number of transactions, according to S&P Capital IQ data. Approximately 21 percent of the U.S. transactions closed in 2018 were in the IT sector, and 19 percent of the U.S. transactions were in the Industrials sector. These numbers are similar to the industry breakdown of M&A activity that was seen in 2017.

In terms of deal volume, the Energy sector once again led the U.S. market with deal volume totalling $407.5 billion, accounting for a 23.6 percent share of the U.S. M&A market according to Thomson Reuters data. The IT sector followed, with $324.8 billion in deal volume accounting for an 18.8 percent share of the U.S. M&A market. The Health Care sector rounded out the top three sectors, by volume, representing $215.4 billion in deal volume and a corresponding 12.5 percent U.S. M&A market share.

Key Developments

Case Law Developments

There have been certain significant decisions in 2018 originating out of the Delaware courts that are of particular interest to the M&A legal community. The cases highlighted below are among the most notable:

- As discussed elsewhere more extensively in this volume, in *Akorn, Inc. v. Fresenius Kabi AG*, the Court found, for the first time, the occurrence of a material adverse effect (MAE) between signing and closing of a purchase agreement, thereby permitting the valid termination by Buyer of such purchase agreement. This case involved an extreme set of facts supporting an MAE, including a drastic and "durationally significant" business downturn, whistleblowers, "pervasive compliance problems" and "widespread regulation violations" and confirmed that Delaware courts will enforce all contract provisions, including MAE provisions, in accordance with their terms upon an appropriate evidentiary record. Despite this finding, which was affirmed by the Delaware Supreme Court, practitioners should continue to negotiate for specific, bright-line triggers for the MAE definition because a Buyer has a high bar to establish the occurrence of an MAE.

- In *Manti Holdings, LLC v. Authentix Acquisition Co.*, the Court held, for the first time, that a contractual appraisal waiver in a board-approved sale was enforceable against holders of common stock (the Court had previously upheld prospective waivers by holders of preferred stock, whose rights are primarily contractual in nature). The stockholders' agreement had provided that they "refrain" from exercising, without expressly waiving, appraisal rights, leading the plaintiffs to argue that their appraisal rights were not extinguished, but only temporarily suspended. This case involved an appraisal action brought by holders of common stock under Section 262 of the Delaware General Corporation Law (as amended, DGCL) in connection with a cash merger in which they would receive little, if anything, for their shares. The merger was initiated by the controlling stockholder, The Carlyle Group, pursuant to the exercise of drag-along rights, which allowed it to force a sale of the portfolio company, under a stockholders' agreement, to which the appraisal petitioners were parties. The ruling brings certainty to private equity investors who customarily include drag-along provisions and appraisal waivers in their investment documents and flags the importance of including appropriate language expressly waiving appraisal rights.

- *Eagle Force Holdings LLC v. Campbell* involved a question as to whether certain documents signed by the transaction parties met all requirements to be fully enforceable agreements. In this case, the Delaware Supreme Court enunciated a clear standard as to whether a contract has sufficiently definite terms so as to be valid: "A contract is sufficiently definite and certain to be enforceable if the court can – based upon the agreement's terms and applying proper rules of construction and principles of equity – ascertain what the parties have agreed to do." In the matter at hand, the parties' execution of transaction documents marked "DRAFT" with blank schedules and several unresolved issues was ruled not to be binding. Equally interesting to the deal community was the inclusion of a footnote in the opinion by the Court that suggested that Delaware law is not as settled as previously thought on the issue of whether a Buyer must prove reliance on a contractual representation or warranty to recover for a breach. The footnote provided that the majority of states do not require proof of reliance for recovery in cases of breach of an express representation or warranty, but that Delaware "has not yet resolved this interesting question". A Buyer, therefore, should consider whether to negotiate for an express "pro-sandbagging" clause in order to avoid disputes about what they knew and when they knew of a breach of a Seller's contractual representations and warranties. At the very least, this footnote opens the issue for debate.

- *Morrison v. Berry* represents a continued refining of the so-called *Corwin* doctrine, which provides business judgment rule deference to directors in the case of transactions that are approved by a majority of disinterested, fully informed and uncoerced stockholders. In contrast to some of the decisions covered in the 7th edition of *Global Legal Insights – Mergers & Acquisitions*, this case turned on whether the voting stockholders were truly "fully informed" in light of several material disclosure violations regarding the role of a significant stockholder in a sale process (such as his undisclosed prior dealings with the buyer, pressure on the board and other external influences that may have impacted the transaction process), which came to light as a result of a demand for books and records under Section 220 of the DGCL. The Delaware Supreme Court reversed the lower court's dismissal, which was based on application of the *Corwin* doctrine, similar to another 2018 reversal by the Delaware Supreme Court in *Appel v. Berkman* due to material disclosure deficiencies for a transaction. The protections of business judgment review will not be applied to stockholder-approved transactions when "partial and elliptical" disclosures leave voting stockholders with an unclear and incomplete view.

- *Flood v. Synutra International, Inc.* clarified that the MFW *ab initio* (meaning "from the beginning") requirement for application of the deferential business judgment rule to a controlling stockholder transaction, is satisfied so long as such stockholder conditions its offer on both of the requisite MFW procedural protections prior to the commencement of any economic negotiations between the special committee and the controlling stockholder. In a 2014 case, *Kahn v. M&F Worldwide Corp.* (MFW), the Delaware Supreme Court had established that the director-friendly protections of the business judgment rule will apply to a going private transaction proposed by a controlling stockholder when the controlling stockholder conditions the transaction *ab initio* on two procedural protections: (1) approval by an independent, fully empowered special committee that fulfils its duty of care; and (2) the uncoerced, informed vote of a majority of the minority stockholders. In *Flood v. Synutra International, Inc.*, the plaintiff argued that the MFW requirements were not met because the controller's initial offer was not conditioned on either of the two requisite procedural safeguards, and it was only after the formation of the special committee that he sent a second offer letter containing these two safeguards. While the Court affirmed the dismissal of the plaintiff's action, citing compliance with MFW requirements, the vigorous dissent urging adoption of a bright-line rule regarding the first offer should encourage a strict adherence to the MFW procedures.

- In *Sciabacucchi v. Salzberg*, the central question was whether forum selection provisions in a certificate of incorporation that require federal securities laws disputes to be brought only in Delaware federal courts, are enforceable. The courts had previously affirmed, most recently in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, that bylaws could require that fiduciary duty actions and other corporate governance disputes be filed only in Delaware state and federal courts, which was later codified by the Delaware legislature. However, in this case, the Court ruled that such requirements were not enforceable with respect to federal securities disputes because the federal Securities Act of 1933 gave concurrent jurisdiction to state courts over disputes arising under it. Further, the Court held that forum selection provisions were invalid for a body of law that was external to the corporate contract and did not involve the internal affairs of the corporation.

- *In re Tesla Motors Inc. Stockholder Litigation* highlighted the rare scenario where a minority stockholder could exercise sufficient control, even at a 22.1 percent ownership threshold, that a transaction could be subject to the stringent entire fairness review in the absence of other procedural safeguards. In this case, Elon Musk, the

founder and largest stockholder of Tesla Motors (holding 22.1 percent of the stock) and the founder (together with his cousins) and largest stockholder of SolarCity (holding 21.9 percent of the stock), was found to dominate the board in its discussions over the proposed acquisition by Tesla Motors of SolarCity. Although the Delaware courts seldom find control where ownership levels are this low, this Court concluded, for purposes of the motion to dismiss before it, that Musk was a controlling stockholder of Tesla Motors with respect to the SolarCity transaction due to: (1) Musk's history of removing management when displeased; (2) the board's lack of procedural safeguards, such as the formation of an independent special committee, to mitigate his potentially coercive influence; (3) voting board members interested in the transaction or not independent of Musk due to personal and business ties; (4) public filings acknowledging his outsized influence; and (5) Musk himself led the board's discussions and engaged the board's advisors for the proposed acquisition. The Court has shown it is willing to look past low percentage ownership levels of a minority stockholder who is on both sides of a transaction if the facts suggest that there are indicia of control over the board and the company, without appropriate cleansing procedures, to merit an entire fairness review.

- In *City of North Miami Beach General Employees' Retirement Plan v. Dr. Pepper Snapple Group Inc.*, the Court refined its approach to appraisal rights under Section 262 of the DGCL by clarifying the meaning of a "constituent corporation" under that Section. In this case, the Court decided that stockholders of the Dr. Pepper parent entity in a reverse triangular merger lack appraisal rights and that only the stockholders of the entity actually being merged or combined (i.e., a "constituent corporation") are entitled to petition for such rights. The Court held that the parent's continuing stockholders were not entitled to appraisal rights due to this literal reading, notwithstanding the fact that control had shifted to the target's stockholders who held approximately 87 percent of the parent post-merger while the legacy Dr. Pepper stockholders then held 13 percent. This case gives transaction parties additional certainty as to how Delaware courts will evaluate deals subject to Section 262 of the DGCL.

FIRRMA and Antitrust Developments

On August 13, 2018, the U.S. Foreign Investment Risk Review Modernization Act (FIRRMA) was signed into law. FIRRMA aims to reform and expand the interagency Committee on Foreign Investment in the United States (CFIUS) process currently used to review acquisitions by foreign persons of, or investments by foreign persons in, U.S. businesses

from a national security perspective, with particular scrutiny of transactions with China. FIRRMA implements a number of changes to CFIUS as a whole, generally falling into two major areas: increasing CFIUS' jurisdictional reach over a broader set of "covered transactions"; and amending the existing CFIUS review process to now require mandatory declarations for investments, whether controlling or non-controlling, in U.S. businesses involved in critical technologies.

CFIUS has been given latitude to further define the scope of covered transactions through its regulations. FIRRMA has expanded CFIUS so that it no longer covers only foreign acquisitions of controlling interests in relevant companies. Going forward, any non-passive, non-controlling foreign investment in foundational technology or critical infrastructure, or into companies dealing with certain sensitive U.S. personal data, now falls solidly under CFIUS' purview. Further, real estate transactions (whether structured as a sale, lease or concession, whether developed or undeveloped land) involving air or maritime ports or close proximity to a U.S. military installation or other sensitive U.S. government properties, are subject to CFIUS review.

For purposes of determining a "foreign person" under CFIUS, private equity funds with foreign limited partners may not be "foreign persons," and therefore may fall outside the scope of CFIUS. To do so, they must meet certain criteria such as management exclusively by a U.S. general partner, the absence of approval or block rights by investors over general partner decisions and the lack of access by investors to material non-public technical information. Conversely, private equity fund structures that provide foreign limited partners with access to material non-public technical information, board or observer rights or any other involvement in substantive decisions (other than through the voting of shares), of certain U.S. portfolio companies will not fall outside CFIUS' jurisdiction because such investments are non-passive. The U.S. portfolio companies at issue are those dealing with the use, release or maintaining of sensitive personal data of U.S. citizens, the use, acquisition or release of critical technologies or the management, operation or supply of critical infrastructure. FIRRMA also gives CFIUS the ability to institute new filing fees, which will be shaped by further regulation. This fee will be capped at the lesser of 1 percent of the value of the transaction or $300,000, and will only be applicable to transactions requiring full standard notice, not for the five-page mandatory declarations discussed below.

In October 2018, the U.S. Department of the Treasury issued interim regulations and introduced a "pilot program." The new pilot program further implemented certain FIRRMA provisions, including the requirement for the filing of mandatory declarations by foreign persons acquiring either controlling or non-passive, non-controlling interests in U.S. companies involved with critical technologies in 27 specified industries such as electronics, semiconductor manufacturing and nanotechnology/biotechnology research and development. Critical technologies include: defense articles or defense services on the U.S. Munitions List set forth in the International Traffic in Arms Regulations; items on the Commerce Control List set forth in the Export Administration Regulations (when controlled for specific reasons); certain specially designed and prepared nuclear equipment, parts and components, materials, software, and technology; select agents and toxins; and yet to be named emerging and foundational technologies. The mandatory declaration must be filed at least 45 days prior to the closing. Upon receiving a mandatory declaration, CFIUS will begin a review process, which is statutorily limited to 30 days. Upon completion of the review, CFIUS may: (i) request the parties file a full standard notice; (ii) inform the parties that CFIUS is unable to reach a decision and that the parties may file a full standard notice regarding the transaction; (iii) initiate a unilateral review of the transaction; or (iv) clear the transaction. Failure by the parties to file mandatory declarations under the pilot program carries potentially harsh penalties. CFIUS is authorised to pursue civil penalties up to the full value of the transaction. It remains to be seen how aggressively this penalty will be pursued, but it is worth noting that 2018 marked the first time CFIUS imposed a monetary penalty: a $1 million penalty for violation of a mitigation agreement in connection with an unnamed party. More broadly, CFIUS may negotiate mitigation agreements to address national security risks of particular transactions and in extreme cases, has authority to unwind a transaction.

The mandatory declaration is a five-page mandatory filing, instead of the longer 45-page voluntary filing. However, while the intent of these short-form declarations may have been to streamline and expedite the review process, it has not resulted in quicker review by CFIUS staff already at capacity. In most cases, these declarations will end up in the "regular" review process, requiring submission of the lengthier filing, particularly if there is any complexity or perceived risk. The desired streamlining may yet occur, once additional personnel and attorneys have been hired to support CFIUS review as a result of a pending Department of Justice (DOJ) budget increase earmarked for this purpose. Notably, CFIUS is also establishing an office to review transactions that do not make a CFIUS notification.

The long-term effects of FIRRMA will not be known until CFIUS has had time to fully promulgate new regulations implementing the Act, which will be done no later than February 2020. There are several areas to watch as FIRRMA continues to evolve through future CFIUS regulations. Among the questions still to be answered is whether FIRRMA regulations will address joint ventures located overseas between foreign and U.S. companies. Restrictions on foreign joint ventures centered on reducing technology outflow from the United States were previously proposed. However, these restrictions were not included in the version of FIRRMA that was enacted in August. Interestingly, the interim regulations implemented in October do explicitly mention joint ventures as transactions that could result in foreign control of a U.S. business. The U.S. Export Control Reform Act of 2018, instead of FIRRMA, may be the tool through which the proliferation of critical technologies to foreign countries using a joint venture is constrained. The definition of "foreign person" may be further refined in future regulations to exempt investors from the mandatory filing requirement through a "white list" of friendly countries. Another area to monitor is the mandatory filing triggered by non-controlling investments in companies that maintain or collect "sensitive personal data," which, given current data-rich business models, could cover an extensive set of companies today.

In a transaction that highlighted the reach of CFIUS in 2018, the U.S. President blocked, through executive order, what would have been the largest technology deal ever – the $117 billion hostile bid by Broadcom, a Singapore chipmaker, to acquire California-based Qualcomm – citing national security concerns in ordering both companies to immediately abandon the proposed transaction. This move came soon after CFIUS issued a negative recommendation. Pointedly, CFIUS expressed concern that Qualcomm and, by extension, the United States, could be disadvantaged in the race to develop next-generation 5G wireless technology against rivals such as China's Huawei Technologies Co., the largest supplier of telecommunications network equipment and the second-largest maker of smartphones, which in May 2019 was added to a U.S. trade blacklist. The swiftness of the decision was broadly seen as the U.S. President leveraging escalating tension with China to send a clear message about foreign investment in American technology. Recently, in 2019 CFIUS ordered a divestiture by a Chinese gaming company, Beijing Kunlun Tech Co. Ltd. (Kunlun Tech), of its interest in Grindr, LLC, a popular LGBTQ dating application, which includes a user's location and HIV status. Kunlun Tech had not previously made a CFIUS filing in connection with its acquisitions of Grindr stock. In that transaction, CFIUS may have focused on the potential vulnerability to blackmail of military and intelligence officers whose data was available to the application.

Functionally, FIRRMA has given CFIUS a focus on foreign technology investments and empowers it to examine a wider range of deals. Practically speaking, these changes lay the framework for a more far-reaching and powerful CFIUS that could transform how acquisition and investment transactions are being sourced, structured, financed and executed. For example, sellers are more frequently requesting reverse termination fees for CFIUS failures secured by escrows with Western banks and requiring divestitures, and transaction parties are more focused on the interim covenants, given a potentially extended executory period. Many details of how FIRRMA will work to alter the process will continue to be made clear through the enactment of additional CFIUS regulations. Companies, lenders and acquirors will need to take these changes into account going forward and continue to monitor CFIUS developments to ensure compliance.

In connection with the antitrust aspect of transactions, 2018 saw more extensive scrutiny of “vertical transactions” with the other party’s customers or suppliers from the DOJ and the Federal Trade Commission (FTC), the chief antitrust/competition regulators in the United States. This was observed in both the DOJ’s challenge to the AT&T/TimeWarner transaction and their investigation of the CVS/Aetna transaction. Health Care and Technology sectors were among the sectors where U.S. federal agencies seemed to focus their reviews. For example, the Cigna-Express Scripts deal with a value of $67 billion survived nearly 30 state regulatory reviews and input from the DOJ, and in the CVS/Aetna deal, regulators were able to secure major concessions from the companies, including the DOJ requesting that Aetna sell its Medicare Part D business to WellCare Health Plans.

Companies are increasingly finding it necessary to be flexible to appease regulators. In order to win approval from regulators for its $63 billion acquisition of Monsanto, Bayer was required to divest two of its business units. These divestures, for a seed and herbicide unit and for a vegetable seed unit, led to two additional transactions, each closing for value in the area of $9 billion. Lastly, the DOJ and the FTC are taking note of larger companies that may be acquiring emerging competitors in the Health Care and Technology sectors, with the DOJ preparing to open an antitrust investigation of Google and the FTC considering doing the same with both Facebook and Amazon.

Year Ahead

When it comes to measuring the success of the global M&A market, the year 2018 was largely a tale of two halves. Despite the tremendous deal volume in 2018, the forward momentum stalled significantly in the 3rd and 4th quarters. This drop was partly due

to concerns over a potential rise in interest rates, increased protectionism and punitive tariffs. Increased caution over the state of economic growth as a whole and sharpening fears of a global recession also took a toll on eroding institutional confidence. On the whole, some buyers may have delayed or even abandoned planned spending and expansion for the time being. Overall, U.S. deal volume in the second half of 2018 dropped over 20 percent from levels shown in the first half of the year and the global M&A market saw a dip of over 30 percent.

On the other hand, there is greater stability and certainty around the short-term domestic political climate due to the Democrats winning control in November of the U.S. House of Representatives for the next two years. As a result, it is less likely that a dramatically different legislative agenda will be passed. The international political climate, though, is still plagued by uncertainty arising from continued trade tensions with China, Mexico and most recently, India, the impact of Brexit and U.K. Conservative party leadership elections (the victor of which will become prime minister), and the expanded reach of CFIUS. These factors will have a dampening effect on the volume of cross-border transactions.

Nonetheless, there are large corporate cash reserves resulting from increases in savings, unprecedented profits and the favorable impact of the U.S. Tax Cuts and Jobs Act of 2017 (the JOBS Act). The JOBS Act, among other things, launched Qualified Opportunity Zones (QOZs), a designation for underprivileged communities where new investments may be eligible for preferential tax treatment. These corporate cash reserves are in addition to what is believed to be over $1 trillion in available capital in the private equity area, which is now exploring investments in over 8,700 different QOZs designated across the United States.

The data of the first quarter of 2019 did evidence a recovery in the levels of dealmaking from the dip towards the end of 2018: U.S. deal volume, which had dropped to levels as low as $70.61 billion in December 2018, rebounded to $197.71 billion in January 2019 and was solidly at $186.69 billion in April 2019. Notwithstanding the darkening clouds of regulatory uncertainty, unease over high valuations and geopolitical conflict on the horizon, 2019 should see continued healthy levels of dealmaking. The fears of a recession coming in 2020 and a slowing of the global economy may negatively affect company valuations. Financial sponsors are expected to use their dry powder to take advantage of this opportunity to invest in more attractively priced assets, further increasing the role that private equity plays in the overall M&A market. This changing dynamic is a key trend that will continue to reshape the M&A landscape in the year ahead.

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Legal Considerations for Establishing Operations in the United States

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Business and Legal Climate in the United States

The business climate in the United States, though subject to business cycles, is the largest, most dynamic and durable in the world. The freedom to compete gives would-be entrants the greatest opportunity to succeed and entrenched players the greatest risk of failure. Central to the business climate is the virtual absence of political risk and the stability and predictability of the legal system.

Although stories of runaway punitive damage verdicts give many business executives pause about investing or doing business in the United States, it is estimated that plaintiffs prevail in civil cases less than 60 percent of the time. In cases where the plaintiff both sought punitive damages and won at trial, punitive damages were awarded 36 percent of the time. In cases where the plaintiff both sought punitive damages and won at trial, punitive damages were awarded 36 percent of the time. Within those rare awards, so-called "blockbuster" verdicts are exceedingly rare; only 137 punitive damage awards exceeding $100 million were imposed between 1981 and 2013. Instead, as of 2005, the

median overall punitive damage amount awarded to plaintiff winners in civil cases was $64,000. On the other hand, courts follow prior decisions in determining the outcome of a lawsuit, and that gives businesses the ability to predict the likely outcome of a particular course of conduct and comfort in the sanctity of contracts.

The U.S. tax system, although very complex, is generally less burdensome than most countries' when you consider income, VAT, employment and property taxes combined. Moreover, the United States is party to myriad bilateral tax treaties that reduce or eliminate many of the duplicate tax burdens between countries.

Limitations on Conducting Business in the United States

Restrictions on Foreign Investment and Control

Generally, the United States has proven to be a desirable location for foreign investment. Few controls are imposed on investment by foreign entities that are not imposed on domestic entities. However, federal law does restrict and regulate permissible levels of foreign ownership and control in certain key industries.

National Security and Defense. Established in 1975, the Committee on Foreign Investment in the United States (CFIUS) is an interagency panel that screens transactions involving foreign investment in the United States for potential security risks. Members of the State, Defense, Justice, Commerce, Energy, Homeland Security and Treasury Departments send CFIUS's recommendation to the president, who has the power to suspend or prohibit a deal. CFIUS has been strengthened over time with legislation, including the Exon-Florio amendment to the Omnibus Trade and Competitiveness Act of 1988, the Foreign Investment and National Security Act of 2007, and the Foreign Investment Risk Review Modernization Act of 2018. The jurisdiction of CFIUS review includes not just mergers, acquisitions or takeovers resulting in foreign control of commerce but also investment in U.S. companies involved in critical technology or other sensitive sectors. For transactions involving certain industries for which the U.S. government deemed that "strategically motivated foreign investment could pose a threat to U.S. technological superiority and national security," mandatory declarations are required. Factors considered in CFIUS review include whether a transaction presents national security risks and whether other provisions of law provide adequate authority to address the risks. While CFIUS's review has been broadening, the trend of increased regulatory scrutiny of national security-sensitive transactions appears to be reflected across many countries globally.

Nuclear Power. The Nuclear Regulatory Commission (NRC) issues licenses for the use of nuclear material for medical, industrial and commercial purposes, including research and development. The NRC is prohibited from issuing licenses for the production and handling of atomic energy to any individual, corporation or entity that is owned, controlled or dominated by a foreign corporation or foreign government. The policy rationale behind this is the protection of domestic defense, security, health and safety. The NRC may enter any nuclear facility to recapture nuclear material and operate the facility to assure proper use, preservation and safeguarding of the material in order to promote the common defense and security of the United States.

Generally, foreign investors may participate in NRC-licensed activities if the foreign entity does not hold a majority interest in the venture and the licensed activities are controlled by U.S. citizens. In the past, the NRC has imposed the following licensing conditions on foreign participation in the applicant's licensed activities: (1) the foreign entity cannot hold more than a 50 percent ownership interest in the venture; (2) the directors, officers and managers of the licensed entity must be U.S. citizens who are not controlled by, or under the influence of, a foreign entity or person; (3) officers and employees of the venture responsible for the custody and control of nuclear materials must be U.S. citizens; and (4) only persons with security clearances and permits may have access to restricted data involving plant technology. These factors may not be the only conditions the NRC will impose on a foreign investor seeking to own a portion of a U.S. domestic nuclear power plant. In addition, the NRC always considers the form of the venture and the nature and extent of foreign participation.

Recently, major legislation was enacted governing this sector. The Nuclear Energy Innovation Capabilities Act of 2018 updates the mission and objectives of the Department of Energy's civilian nuclear energy programs, and the Nuclear Energy Innovation and Modernization Act of 2019 creates a new licensing framework for advanced reactors and adjusts the fee structure as it applies to both traditional nuclear power plants and innovative reactors. On September 25, 2018, an additional piece of legislation passed the U.S. House of Representatives and was referred to the U.S. Senate's Committee on Environment and Public Affairs. If enacted, the bill, H.R.1320 - Nuclear Utilization of Keynote Energy Act, would require a report to Congress "containing the results of a study on the feasibility and implications of repealing restrictions . . . on issuing licenses for certain nuclear facilities to an alien or an entity owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government." Due to the rapidly changing legislative and regulatory framework governing nuclear power, readers interested in establishing U.S. operations in this area are advised to discuss further with their legal counsel.

Public Utilities. Under the Energy Policy Act of 2005, a "holding company" is defined as "any company that directly or indirectly owns, controls, or holds, with power to vote, 10 percent or more of the outstanding voting securities of a public-utility company or of a holding company of any public-utility company" or "any person . . . [who] exercises directly or indirectly (either alone or pursuant to an arrangement or understanding with one or more persons) such a controlling influence over the management or policies of any public-utility company or holding company as to make it necessary or appropriate for the rate protection of utility customers with respect to rates . . . ." Holding companies are subject to the oversight of the Federal Energy Regulatory Commission (FERC). However, foreign utility companies are exempted from the definition of holding companies because FERC's "main regulatory interest is to monitor the costs incurred by traditional utilities providing monopoly service in order to ensure reasonable rates." Accordingly, foreign entities seeking to acquire an interest in a U.S. utility may be able to avoid certain FERC requirements by qualifying as exempt. Recent legislative reforms are predicted to result in nontraditional investment in the U.S. public utility sector, including by diversified foreign investors and certain foreign banks and pension funds.

Maritime Industries. Based on the same national security rationale, federal law requires that all merchant marine vessels must be owned and operated privately by citizens of the United States. The merchant marine fleet serves as a military auxiliary in times of war and national emergency and is essential to foreign and domestic commerce. Accordingly, all merchandise to be transported by water, or by land and water, between points in the United States must be carried by vessels built in and documented under the laws of the United States, and owned by U.S. citizens. Additionally, a U.S. owner is prohibited from selling any interest in a vessel to a non-U.S. citizen without the approval of the Department of Transportation. (This does not apply to certain pleasure and fishing vessels.)

Federal Regulation of Foreign Investment and Control

Federal law limits or regulates foreign ownership and investment in the following industries:

Airlines. U.S. citizens must own 75 percent of the voting shares of an air carrier, as well as constitute at least two-thirds of the board of directors and managing officers, and the carrier must be under the actual control of U.S. citizens. In addition, the president of the air carrier must be a U.S. citizen. The Department of Transportation is primarily con-

cerned with voting equity, but extensive foreign equity ownership absent voting power may result in a denial of participation. A foreign airline is permitted to own up to 49 percent of the total equity, but the limit of 25 percent of the voting equity remains.

Media and Communications. The laws governing the communication industry are the key area of federal foreign investment regulation. These laws are intended to promote competition and reduce regulation to encourage quality services at low prices and rapid development of new technology. The Telecommunications Act of 1996 gives the Federal Communications Commission (FCC) the discretion to refuse to license (television, radio, common carrier, broadcasting, aeronautical services, cellular, and microwave and satellite communication) any corporation directly or indirectly controlled by any other corporation of which more than 25 percent of the capital stock is owned of record or voted by foreign persons, their representatives, a foreign government or any corporation organized under the laws of a foreign country. The FCC presumes that indirect foreign ownership of common carrier radio licensees up to 100 percent is consistent with the public interest when the foreign investor is from a World Trade Organization (WTO) member country, absent compelling evidence to the contrary. When the foreign investor is not from a WTO member country, the FCC applies a four-prong Effective Competitive Opportunities (ECO) analysis to authorizations of foreign investors seeking to acquire either a controlling interest or more than a 25 percent interest in a U.S. communications carrier. The ECO test examines whether a foreign market is open by considering the following: (1) the presence of legal barriers to market entry by entities foreign to that market; (2) whether interconnection is permitted under reasonable and nondiscriminatory charges, terms and conditions; (3) the presence of competitive safeguards (i.e., rules against cross-subsidization); and (4) the existence of a regulatory agency to protect the competitor.

Banking. The International Banking Act of 1978, as amended, mandated that the Federal Reserve must approve the establishment of U.S. offices by foreign banks if the bank is under comprehensive and consolidated regulation by its home country's authority.

Mineral Leases and Timber Rights. Deposits of natural resources and the lands containing them owned in the United States are available for exploitation by U.S. citizens, but not to foreigners, unless their home country grants comparable rights to Americans. Foreigners may hold mineral leases through their interests in U.S. corporations, provided that their home country does not deny similar rights to Americans. Aliens who are bona fide residents of the United States may obtain access to timber on federal lands.

Outer Continental Shelf Activities. Federal regulations govern the outer continental shelf and offshore leases. Foreign access is not prohibited because there is no citizenship requirement. Statutory provisions limit manning outer continental shelf rigs, vessels and platforms to U.S. citizens, with some exceptions.

State Restrictions on Foreign Ownership and Control

Many states impose additional restrictions on foreign ownership of businesses. Under Pennsylvania law, for example, an alien who is not a resident of a state or territory of the United States or of the District of Columbia, or a foreign government cannot acquire an interest in agricultural land exceeding 100 acres, except such as may be acquired by devise or inheritance, and such as may be held as security for indebtedness. This law does not apply to citizens, foreign governments or subjects of a foreign country whose rights to hold land are secured by treaty.

Choice of Form of Business Enterprise. The choice of the state in which to organize or incorporate an entity is similarly important. Business entities are creatures of state law, not federal law. A business entity can incorporate or form in any state it chooses, and its internal affairs are governed by the law of that state, even if the entity does not do business in that state. These laws can vary substantially from state to state. Federal laws, however, are uniformly applicable to business entities throughout the United States. With the help of legal counsel, you should determine which state may be preferable for forming your business entity and for compliance with state requirements. Issues to consider in these decisions include state requirements for various forms of business structure, corporate governance, stock and other securities requirements, labor and employment requirements beyond federal law, tax issues, and environmental laws. Let’s briefly examine some of these critical issues for businesses.

Under the Delaware General Corporation Law (DGCL), the law applicable in the state most commonly chosen for incorporation, foreign investors can do business in the state by (1) forming a joint venture with an existing business enterprise; (2) acquiring an existing enterprise or subsidiary of another corporation; or (3) creating an enterprise owned by the foreign investor’s company, such as a new subsidiary, or a more informal structure, such as a liaison office or branch office of the foreign investor’s company.

Joint Ventures. Joint ventures can take the form of any legal vehicle, but usually are either (1) a simple contractual relationship, (2) a partnership or (3) a joint corporation.

Advantages and disadvantages apply to each form. Factors to consider in choosing one of these forms include the size and complexity of the proposed venture, the anticipated length of the joint venture, the relationship among the parties, tax burdens and benefits, and cash flow.

Simple contractual relationships are flexible, easily terminated and generally can be kept far more secret than other forms of joint ventures. However, the contract for these ventures must be carefully drafted to avoid problems down the road, and a court could hold the contractual joint venture to be a *de facto* partnership, obliging the investors to the fiduciary duties of that form of entity. In general, contractual joint ventures should be used for short-term, specific activities, such as an agreement between two companies to jointly develop a new product or service. If the contractual arrangement includes the sharing of profits or losses, the arrangement may create a partnership for U.S. tax purposes, even if it is not formed as an entity. See below for tax consequences.

Partnerships. Partnerships generally are characterized by unlimited joint and several liability of the partners and restrictions on the assignment of partnership interest, particularly to non-partners. There are three types of partnership agreements: (1) general partnerships, (2) limited partnerships and (3) limited liability partnerships. General and limited liability partnerships are particularly common joint venture vehicles for commercial real estate and construction activities, and when a small group of trusting and familiar investors want to take advantage of tax transparency. Limited partnerships are rarely used as joint venture vehicles because they usually are structured with one general partner and several passive investors, with greatly limited ability to be involved in the operations as limited partners, but this form may be ideal if one party wants total control over the joint venture and the others only want to share in the profits.

Corporations. A jointly owned corporation is the standard form of joint venture used when the venture has any economic significance and when the parties want the venture to be disclosed to the public. The preferred corporate forms are the business corporation and the limited liability company. The business corporation often is used by companies that want the venture to be publicly listed on a stock exchange, to gain more shareholders and then progress independently of the shareholders. This form also is often a precursor to a merger of the companies involved in the joint venture. Limited liability companies usually are not used when the parties want the venture publicly listed; rather, they are used for investments or opportunities that will grow organically and not as acquisition vehicles. Limited liability companies allow for “pass-through” taxation, where profits are not taxed on the company level, but are taxed at the member level while providing the same liability protection as afforded to a limited partner in a limited partnership.

Acquiring an Existing Business Enterprise or Subsidiary of a Foreign Corporation. Foreign investors can acquire these types of entities by acquiring the assets of the business or acquiring enough stock to assert *de facto* control. Asset acquisitions of going business concerns carry important tax and legal consequences. The purchase price of the assets will become the new tax basis for those assets, usually resulting in a higher tax basis and higher tax depreciation deductions than purchasing stock in a business corporation. Purchasers in asset acquisitions usually can avoid the liabilities of the seller, including liabilities for back income taxes.

In an asset acquisition, the buyer also is not obliged to assume any collective bargaining agreement with the seller's employees and can set initial terms of employment with the seller's workforce (with certain important limitations). Foreign investors should consult with counsel about other important tax and legal consequences of an asset acquisition.

Stock acquisitions also carry important tax and labor consequences. By purchasing equity interest in a business that is taxed as a corporation, the buyer inherits all tax attributes (such as basis) of the equity, as well as all tax liabilities and other liabilities, although normally tax loss benefits are limited or eliminated. In a stock acquisition, unlike an asset acquisition, the buyer must assume any preexisting collective bargaining agreements. Again, foreign investors should consult with legal counsel about other important consequences of stock acquisitions.

A third way to acquire a going concern is a merger. Again, important tax and legal consequences apply. Presumably, the foreign entity would incorporate a U.S. wholly owned subsidiary just for the merger. The subsidiary would merge with the target company, which would be the "surviving" business entity of the merger. The foreign entity would own all the stock of the surviving entity, which would retain all of its assets and liabilities, and maintain a separate corporate existence from the foreign entity.

Certain mergers can be completed tax-free, depending on the amount of voting stock, cash or other consideration exchanged in the merger. Analysis of significant tax filing and other obligations must be considered before deciding on such a transaction. As with stock acquisitions, the merged entity must assume any preexisting collective bargaining agreements. As the concept of a merger does not have an equivalent in many foreign jurisdictions, it is essential to have experienced counsel who can harmonize the often conflicting systems.

Acquiring an existing business entity can trigger certain foreign investment control laws. Beyond the complex federal laws that apply to any securities transaction, foreign investors may be subject to special federal acquisition review procedures where the acquisition affects a certain share of the U.S. market. Many states also have “anti-takeover” provisions that can help publicly traded corporations resist “hostile” takeover bids.

Key federal laws include the Securities Exchange Act of 1934, the Hart-Scott-Rodino Antitrust Improvements Act, and the International Investment and Trade in Services Survey Act. The Securities Exchange Act requires investors acquiring more than 5 percent of a business entity’s publicly traded stock to file certain personal and financial information with the SEC. The Securities Exchange Act also governs tender offers (public offers to pay more than the current market price for publicly traded shares of a company the offeror wants to control). The Hart-Scott-Rodino Act requires federal review of mergers or acquisitions when certain market share thresholds are crossed. The required filings, fees and negotiations with the federal government in the event of objections can be onerous. The International Investment and Trade in Services Survey Act requires reporting of all foreign investment in U.S. business enterprises when a foreign entity acquires 10 percent or more of the ownership of a U.S. business in an acquisition the cost of which exceeds $3 million. Several categories of forms must be filed for these investments, depending on the type of business involved.

Anti-takeover laws of many states include a fair price provision, which gives shareholders the right to receive “fair value” for their stock in the event of an acquisition by a shareholder with 20 percent voting power (fair value usually being the price at least equal to the greater of the current fair market value per share of the stock and the highest price paid by the controlling shareholder for shares it previously acquired). These laws also often allow publicly held companies to bar acquisitions or combinations by an interested shareholder (generally the owner of at least 20 percent of outstanding stock), unless the transaction is approved by the board of directors and a majority of shareholders within strict deadlines. Other provisions allow publicly held companies to limit the voting power acquired in certain stock acquisitions and to disgorge profits realized by controlling shareholders following attempts to gain control of the company. The latter provision is designed to prevent controlling shareholders from putting the company “in play,” then profiting from being bought out by a third party or the company itself.

Creation of an Enterprise Owned by the Foreign Investor's Company. Instead of acquiring an existing business, the foreign investor's company could create a new subsidiary, liaison office or branch office.

A subsidiary can be any type of business entity. Forming a subsidiary triggers a number of legal and tax obligations, as outlined above. Let's assume that the subsidiary will be a business corporation. Before starting operations, the subsidiary must:

- draft a certificate of incorporation and bylaws
- capitalize the company
- form a board of directors
- choose corporate officers
- sign the certificate of incorporation and file it with the secretary of state of the state selected for incorporation.

The certificate of incorporation and bylaws must be carefully crafted, as they establish the business name, ownership and voting rights of certain classes of stock, terms, conditions and scope of power for directors and corporate officers, and other critical aspects of business operations. Depending on the capital structure of the corporation, a number of complex securities issues may need to be addressed. Legal counsel should be sought for all of these matters.

Corporate Governance

U.S. federal law also requires ongoing compliance with certain corporate governance regimes as outlined below:

Sarbanes-Oxley: The Sarbanes-Oxley Act, enacted in response to accounting fraud scandals in the early 2000s, has created significant reporting and other compliance requirements for any company, foreign or domestic, that is publicly traded in the United States. Among other requirements, a company must observe certain practices designed to preserve auditor independence and disclose certain financial information and information regarding conflicts of interest. Accounting firms must register with the Public Company Accounting Oversight Board and retain certain records for up to seven years, subject to civil and criminal penalties.

Foreign Corrupt Practices Act: In addition to the laws of nearly all U.S. states, which make it illegal to bribe any U.S. official, there is a comprehensive federal statutory regime that prohibits the willful use of any means to pay, or promise to pay, any official of a foreign government for the purpose of buying his or her influence in his or her official capacity. Violations of the Act come with both civil and criminal penalties.

Regulations for Financial Institutions: Financial institutions in the United States must comply with certain federal laws (in addition to numerous state laws on chartering and lending behavior).

The Dodd-Frank Wall Street Reform and Consumer Protection Act regulates all domestic and foreign companies “predominantly engaged in financial activities,” other than bank holding companies and certain other types of firms. The Act created the Financial Stability Oversight Council and Orderly Liquidation Authority (FSOC), which is granted broad powers to determine whether a nonbank financial company or financial market utility poses a threat to the stability of the U.S. financial system and should therefore be subject to heightened regulation by the Federal Reserve. Acting through the Office of Financial Research, the council can collect financial data from companies and recommend heightened regulation. The FSOC was the subject of a Presidential Memorandum issued April 21, 2017 and responsive Department of the Treasury Report dated November 17, 2017, which contained a number of recommendations regarding FSOC processes. Companies that feel they may be considered systemically important should therefore closely follow any legislative or regulatory updates.

Reforms to the Bank Secrecy Act under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT ACT) require that U.S. financial institutions develop and implement anti-money laundering programs (AML programs). The purpose of the program is to identify funds that may go to criminal and terrorist enterprises. The programs must include the following: (1) internal policies, procedures and controls; (2) a designated compliance officer; (3) ongoing training for compliance personnel; and (4) an independent audit to test the program. In addition, financial institutions must have policies and procedures in place that will help them verify the identity of their customers.

Tax Overview

Federal Taxation. There is no federal VAT in the United States — the federal tax is generally based on the income of the business operation.

Subject to modification by tax treaties, a non-U.S. corporation that conducts business operations in the United States will be taxed under the following regime.

Branch Operations. A non-U.S. corporation that engages in business in the United States is generally subject to a corporate income tax on its income that is effectively connected to a U.S. business. The tax is levied on "taxable income," which is U.S.-connected gross income less applicable deductions, and the maximum federal tax rate as of 2018 is 21 percent. The non-U.S. corporation is required to file an annual tax return on Form 1120F that reports the income and deductions of the U.S. operations. It is important to note that, if a non-U.S. corporation is uncertain if it is engaged in a business in the United States, it may be well advised to file a "protective" U.S. tax return. If the non-U.S. corporation does not timely file a U.S. tax return and the IRS later determines the company was engaged in a U.S. business, the 21 percent tax is imposed on gross income, without the benefit of any deductions.

In addition to the 21 percent corporate tax, the non-U.S. corporation that does business in the U.S. is subject to a "branch profits tax." The branch profits tax is a substitute for a dividend withholding tax because a branch does not pay dividends to its headquarters. In general, unless modified by an applicable tax treaty, the branch profits tax is levied at 30 percent on the net after tax earnings of the non-U.S. corporation that is not re-invested in the U.S. business. Because the branch profits tax is payable even if there has not been a cash repatriation to the non-U.S. corporation, a U.S. corporate subsidiary is frequently preferred over a branch because the dividend withholding tax can be controlled by managing the timing of cash repatriations.

The sale of a U.S. branch gives rise to a U.S. tax charge for the non-U.S. corporation because it is selling assets located in the United States.

Subsidiary Operations. If a non-U.S. corporation forms a wholly owned U.S. corporate subsidiary (or an LLC that is taxed as a corporation), the subsidiary is subject to tax as a U.S. corporation — its worldwide income is taxable on a net basis at a maximum rate of 21 percent. The non-U.S. corporation does not need to file a U.S. tax return, but the U.S. subsidiary will file its own U.S. tax return and may need to file an IRS Form 5472 on which the foreign ownership is identified.

Dividends paid by the U.S. subsidiary to the non-U.S. shareholder are subject to a 30 percent withholding tax, unless modified by an applicable tax treaty. The United States has very few tax treaties that do not contain a “limitation of benefits” (LOB) article. The LOB provisions are very effective at denying treaty benefits to non-U.S. corporations that are not the intended beneficiary of the tax treaty, and preclude most treaty shopping. The United States has not adopted the Multi-Lateral Instrument, and relies only on its tax treaties to determine the tax treatment on non-U.S. persons.

The payment of the dividend withholding tax is generally managed by managing dividend payments. It is noted that, if earnings are unreasonably retained to avoid the dividend withholding tax, the IRS may assert a penalty against the company.

Generally, the sale of the stock of the U.S. subsidiary by the non-U.S. corporation should not result in a U.S. tax charge to the non-U.S. corporate shareholder, unless the U.S. subsidiary is a U.S. real property-holding company.

Joint Ventures. A U.S. venture partner will frequently suggest that a U.S.-based joint venture be housed in a U.S. limited liability company or a U.S. partnership. For U.S. tax purposes, both the LLC and the partnership are pass-through entities (unless they have elected to be taxed as corporations). As a result, if the joint venture is an operating business, the non-U.S. corporate venturer is taxed as described above under branch operations.

The LLC or partnership has an obligation to pre-pay the 21 percent tax of the non-U.S. corporate venture partner on a quarterly basis.

As of December 2017, the sale of the LLC or partnership interest by a non-U.S. corporate venturer is treated as a sale of the underlying assets, and the non-U.S. corporate venturer is subject to U.S. tax on the income that is effectively connected to the U.S. operating business. The disposition of the interest is subject to a 10 percent withholding tax, unless there is an applicable exception, and the taxes withheld are a pre-payment of the actual, final tax imposed.

Disregarded Entity. If a non-U.S. corporation forms a wholly owned U.S. limited liability company and the LLC undertakes the business of the non-U.S. corporation, unless the LLC elects to be treated as a corporation, the non-U.S. corporation will be deemed to undertake whatever the LLC does. So, if the LLC engages in business in the United

States, the non-U.S. corporation is deemed to have a U.S. branch. If the non-U.S. corporation is a treaty-qualified entity and the LLC undertakes solely preparatory and ancillary activities, the non-U.S. corporation will not have a permanent establishment in the United States (although it needs to file Form 1120F, described above in branch operations, and Form 8833 to claim the benefits of the treaty).

State Taxation. While the United States does not have a federal VAT, most states levy their own sales and use tax and income or franchise taxes. The threshold for triggering state taxation may be much lower than that for triggering federal taxation. Generally, the U.S. tax treaties do not cover state taxes and thus the prerequisite for a permanent establishment to tax a non-U.S. corporation does not exist.

Before planning sales into a state, the manner of the marketing and sales should be reviewed for state tax exposure. Under a recent Supreme Court case, known as *"Wayfair,"* the states have expanded power to impose sales tax on persons who sell into the state, even if they have no physical presence in the state.

Antitrust, Unfair Trade and Consumer Protection

Like many other countries, the United States has a regulatory system to deal with antitrust violations, unfair trade practices and consumer protection. U.S. antitrust and unfair practice laws are designed to help keep prices reasonable while deregulating the economy by lifting price controls on most goods and services. Antitrust issues may arise in the acquisition of a U.S. company, and the United States has laws that act as merger and acquisition control procedures. The goal of this merger review is to attempt to prohibit mergers and acquisitions that will have a serious anticompetitive effect on the U.S. economy in relation to any benefits from the transaction. Investors planning to acquire a U.S. company need to structure the acquisition to avoid prohibition and to comply with all notification and filing requirements.

Intellectual Property

Intellectual property rights in the United States for inventions conceived outside of the United States generally are covered by U.S. patent, trademark and copyright law. The foreign investor must meet all proper filing requirements, preserve the rights to intellectual property, and avoid infringing on other parties' intellectual property rights.

Labor Law

Federal and state law prohibit discrimination in employment because of an individual's race, age, gender, national origin, color, religion, disability status or genetic information. State and/or federal laws also govern employee wage payment, including minimum wage

and overtime for certain employees, health and safety, and employee benefits. Federal government applicants and employees are protected from discrimination in personnel based on race, color, sex, religion, national origin, age, disability, marital status, political affiliation, or conduct that does not adversely affect the performance of the applicant or employee — which can include sexual orientation or gender identity.

The National Labor Relations Act gives employees the right to bargain collectively with employers. The law is enforced by the National Labor Relations Board. State law can impose additional requirements on employers. Union membership in the United States has fallen from 20 percent of the workforce in 1983 to 10.5 percent in 2018.

The Patient Protection and Affordable Care Act requires that U.S. businesses employing at least 50 full-time employees provide health insurance to at least 95 percent of their full-time employees. Businesses that fail to provide coverage, or that provide inadequate coverage, to employees will be liable to the IRS for a penalty of up to $3,480 per employee as of 2018.

Litigation and Discovery

Many of our clients are concerned about the burden, cost and risk of U.S. litigation when they consider conducting business in the United States. Like all court systems, the U.S. system has both benefits and risks. As explained at the beginning of this article, the benefits include predictability, stability and fairness. These risks include burden, costs and sometimes high stakes.

When entering into business in the United States, companies can develop strategies for minimizing those risks. We suggest three primary strategies. First, the corporate structure itself can greatly impact the amount of exposure to owners, investors, parents and affiliates. Second, contractual relationships with business partners, including suppliers, purchasers and investors, can contain clauses that explicitly limit liability, and thus total exposure. Third, contracts can also contain international arbitration clauses that may be able to completely exclude certain disputes from the U.S. courts. These clauses, if properly drafted, are generally respected by U.S. courts. International arbitration is often preferred by our international clients because awards are honored internationally by most countries in the world through the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, generally known as the New York Convention, and because there is generally more limited, and thus less expensive, discovery.

If you do become involved in U.S. litigation, it must, of course, be taken quite seriously. It is important to assess the overall risk of your case early on, and to develop strategies for early dismissal of the case. The United States has two court systems — one federal and one state. It is important to work with counsel who is familiar with the type of dispute that you need to defend. You might also need to avail yourself of some of the strengths of the U.S. court system if you have any business disputes that cannot be amicably resolved. The United States is a signatory to the Convention on the Taking of Evidence Abroad in Civil or Commercial Matters and the Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters, which are both Conventions of the Hague Conference. Membership in these Hague Conventions allows for cross-border service of process and evidence gathering.

Litigation risk, of course, can also be minimized through good governance, general compliance with the law, and good and ethical business practices.

Conclusion

This article touches briefly on some of the most important issues to be considered by a foreign company or individual interested in investing or establishing business operations in the United States. Legal counsel familiar with these issues at the federal and state level play a critical role in ensuring the success of such investments and operations.

While government regulation, legal issues and tax issues may seem daunting to a new investor, the regulatory and legal framework is actually less complex than in many countries, and the rules and procedures establish a stable basis for making investment and business operation decisions. Because of this, as well as the size and dynamic nature of the market, the United States remains extremely attractive to foreign investors interested in new or expanding business opportunities.

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