

## Message from Our Boston Office

This issue has a global focus. First, Jane Luxton writes about how the Endangered Species Act is becoming increasingly enmeshed with the green movement, keeping alive the prospect of various litigation.

To recognize the most recent Pepper milestone—our new practice groups devoted to issues of importance to Canada and India—we feature Len Schneidman's article "Are There Sovereign Wealth Funds in India's Future?" and offer details about Pepper's upcoming Canadian Webinar Series.

Our latest Peppercast features Roger A. Lane and Courtney Worcester, members of our Commercial Litigation Practice Group, as they discuss an interesting issue in these trying economic times: how to prevent litigation before entering a major transaction.

In other news, we recently welcomed to the Boston office IP partner James M. Wodarski, who comes to Pepper from the Boston office of Mintz Levin and Corporate and Securities associate Kate Long Salley, who was previously with the Boston office of Goodwin Procter LLP.

As always, we welcome your comments, questions and suggestions.

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## Climate Change and the ESA: Regulatory Decisions Keep Litigation Prospects Strong

This article was originally published on The Horinko Group Web site ([www.thehorinkogroup.org](http://www.thehorinkogroup.org)). It is reprinted here with permission.

In two contradictory decisions announced within the space of ten days - both relating to the polar bear, climate change, and the Endangered Species Act - the Obama administration has managed to anger parties across the political spectrum and create uncertainties about the implications of its actions and the resulting state of the law. On April 28, Interior and Commerce Secretaries Salazar and Locke announced their rescission of a December 2008 Bush administration final rule modifying requirements for the consultation process under section 7 of the Endangered Species Act (ESA). But in contrast to this decision, the Obama administration decided to uphold a companion December 2008 "special polar bear rule," which specifically limited consideration in ESA consultations of adverse effects from actions outside the bear's normal habitat, including CO2 climate impacts from facilities thousands of miles away.

### The Endangered Species Act and the Consultation Quagmire

The ESA, enacted in 1973, is often cited as a prime example of federal environmental statutes that were intended for other purposes but have become enmeshed in the U.S. climate change debate. Under the original consultation rule, agencies that grant permits or take other federal action affecting listed species must consult with the relevant "service agency" - either the Fish and Wildlife Service (FWS) or the National Marine Fisheries Service (NMFS), depending on the species - under ESA section 7 to ensure that the action does not jeopardize the species or result in the destruction or adverse modification of its critical habitat.

If a species is listed because of climate-change related factors, as in the case of certain corals and polar bears, any federal “action” that adds more CO<sub>2</sub> to the atmosphere arguably makes it harder for that species to survive and recover. Such circumstances raise an important question: Can an action agency conclude that the CO<sub>2</sub> emissions from a new power plant, manufacturing facility, road-building project - or even a new hospital, a school, or additions to the federal vehicle fleet - would have “no effect” on a threatened or endangered species, as the courts have interpreted that term?

### Avoiding a Regulatory Nightmare

Although the 2006 listing of elkhorn and staghorn corals for, among other reasons, climate change related factors, had already set the issue in motion, that listing was little noticed. The May 2008 polar bear listing, however, shone a spotlight on the matter. At the time, the Washington Post noted the problem, arguing that if the ESA were to be “used as a backdoor way to regulate greenhouse gas emissions,” the outcome would be “a potential regulatory nightmare.”

To address this concern, the Bush administration’s ESA rule modification authorized action agencies to make consultation determinations without involving FWS or NMFS in circumstances where no take was anticipated and the effects of the action were “manifested through global processes” and “cannot be reliably predicted or measured” at the individual species scale, “would result at most in an extremely small, insignificant impact,” or would pose a “remote” potential risk of harm. Reacting sharply, environmental groups characterized the rule as “lethal,” saying that allowing action agencies to make such a determination on their own - notwithstanding the threat of judicial review - would “eviscerate the Endangered Species Act process.”

Perhaps as a belt-and-suspenders move, in the contemporaneous special polar bear rule, the Bush administration explicitly addressed attempts to link climate change to ESA consultations for that species, effectively ending consultations for impacts potentially caused by global carbon emissions. Critics felt it “falsely asserted that there was no direct link between specific greenhouse gas emissions and the decline in the polar bear’s habitat,” while others not only disagreed with excluding CO<sub>2</sub> emissions, but also feared the “blanket exemption” in the rule would additionally exempt more conventional sources of

contaminants that could negatively affect polar bears, such as oil and gas drilling.

### The April-May Decisions and Their Aftermath

The Obama administration’s decision to rescind the 2008 consultation rule modification was hailed by environmental groups like the Center for Biological Diversity as a “huge victory in favor of sound science and common sense,” while homebuilders and other industry groups denounced the move as adding to confusion about the role of climate change factors in ESA determinations. At the same time, the Center’s spokesman cautioned, “it’s only half the pie,” citing the special polar bear rule, which restricted consideration of greenhouse gas and other factors outside the bears’ current range.

But on May 8, despite receiving letters signed by 41 House members, 130 environmental groups, 1,000 scientists, and 53 law professors urging rejection of the special polar bear rule, Secretary Salazar declared he would keep it in place. At a minimum, these opposite-leaning actions have left ambiguity in their wake, and a closer analysis suggests the results are not what the administration hoped to achieve.

With such intense objection to both rules, the administration’s decision to revoke the consultation rule came as no surprise, but Secretary Salazar’s retention of the special polar bear rule sent shock waves: “Salazar’s decision today is a gift to Big Oil and an affirmation of the pro-industry/anti-environmental policies of the Bush Administration,” said [Center for Biological Diversity’s Noah] Greenwald. Even more tellingly, the environmental groups’ reactions pointed out the inconsistency: “It makes little sense for Salazar to rescind Bush’s national policy barring consideration of global warming impacts to endangered species in general, but keep that exact policy in place for the one species most endangered by global warming - the polar bear,” said Greenwald.”

Secretary Salazar’s press release explained his reasoning for retaining the special polar bear rule: “[T]he Endangered Species Act is not the proper mechanism for controlling our nation’s carbon emissions. Instead, we need a comprehensive energy and climate strategy that curbs climate change and its impacts – including the loss of sea ice.” Ironically, Secretary Kempthorne said virtually the same thing one year earlier: “Listing the polar bear as

*Climate Change, continued on page 6*

## Are There Sovereign Wealth Funds in India's Future?

Forced by the global credit crunch out of the shadow of international finance and into the bright glare of the public spotlight, investments by foreign sovereigns and, in particular, sovereign wealth funds (SWFs), have captured worldwide attention. This is no less so in India, where for the past several years, SWFs have been accepted as investors through the FII (Financial Institutional Investor) route. In the last five years, approximately nine SWFs have invested in India this way. This article briefly explores the background of and policy concerns relating to SWFs, and describes the special United States tax regime applicable to SWFs, in order to inform the current discussion in India concerning the emergence of SWF investment in that country.

### SWF Defined

While there is no single, widely accepted definition of a SWF, broadly speaking they are actively managed, government-owned pools of capital originating in foreign exchange assets. The United States Treasury Department has described SWFs as government investment vehicles that are funded by foreign exchange assets and managed separately from official reserves, and divides them into two categories – commodity funds and non-commodity funds.

### The Current Climate

#### *Increased Visibility*

SWFs have been around for more than 70 years but have had a very low profile – probably because until recently they almost exclusively invested passively, for example, in United States Treasury obligations. However, two recent changes have increased their visibility in the investment world.

First, SWFs have accumulated huge sums of money, in large part because of the fall of the dollar and the surge (through mid-2008) in oil prices. According to various publicly available data sources, SWF assets under management at the end of 2007 ranged between \$3 trillion and \$3.7 trillion and some studies have predicted that by 2012 SWFs would potentially grow to between \$10 trillion and \$12 trillion.

*The scope of the application of Section 892 is related to a number of factors, including the type of income earned, the source of the qualifying income and the recipient of the income.*

Second, SWFs have adopted a more aggressive investment style. This includes major investments in U.S. financial institutions, as well as more acquisitions of operating companies. Finally, SWFs have more widely diversified their portfolio investments, including investments in private equity and hedge fund vehicles.

It should be noted, however, that even SWFs are not immune from global financial disarray, and there are signs that the amount and style of SWF investments may be changing.

#### *Policy Concerns*

The prominence of SWFs and their lack of transparency have led to several distinct policy concerns about the effects of SWF investment. The first concern is that SWFs may pursue political objectives or foreign policy goals that are not strictly financial when making their investments.

Also, because of SWFs' sheer size, there is a worry that they could invest in ways that cause volatility in markets and disruptions in economies. In addition, SWFs may be able to use their status as government instruments to compete unfairly with private investors.

Finally, there is a concern relating to a possible protectionist reaction by an investee country government. By virtue of SWFs' perceived or actual strategic behavior and their potential effects on markets, the local government might consider adopting broad protectionist financial market policies that could harm that country's economy and its foreign relations.

### *Policy Responses*

These policy concerns relating to SWF investment are evident worldwide. In the United States, the government review criteria relating to certain foreign investments that raise national security interests have been tightened. In addition, the United States Treasury Department has entered into an agreement with the governments of Singapore and Abu Dhabi relating to policy principles for SWFs and for countries receiving SWF investments.

Internationally, the Organization for Economic Cooperation and Development (OECD) Investment Committee has initiated an ongoing Freedom of Information Project and issued a report describing agreed principles for recipient countries' treatment of SWF investment. The principles include non-discrimination, transparency, predictability and regulatory proportionality. In addition to the work of the OECD, the International Monetary Fund has established an international working group tasked with establishing "best practices" guidelines for the management of SWFs.

### **U.S. Taxation of SWFs**

#### *History of Section 892*

The rules governing the taxation of U.S. investments by SWFs are contained in Section 892 of the Internal Revenue Code. The history and scope of Section 892 broadly followed the history and scope of the international law principle of sovereign immunity – that is, one country is immune from the jurisdiction of the courts of another country. The scope of the immunity evolved during the 20th century from one of absolute immunity (i.e., a country enjoys immunity in all cases) to one of restrictive immunity (i.e., a country is denied immunity in certain cases, such as those arising out of the commercial activities of that country). The adoption by the United States of a restrictive theory of immunity was announced by the State Department in 1952 and subsequently enacted into law in the Foreign Sovereign Immunities Act of 1976.

An exemption from U.S. tax for certain income received by foreign governments first appeared as early as 1917. Various changes to the exemption were enacted throughout the years with a significant narrowing of the exemption in 1980 to include only integral parts and controlled entities of a foreign government and to exclude income derived from commercial activities in the United States.

## Canadian Webinar Series

### *Foreign Corrupt Practices Act Effect on Canadian Companies*

September 30, 2009 | 12:00 – 1:00 P.M. EASTERN

Mr. Paw will discuss major enforcement efforts under the U.S. Foreign Corrupt Practices Act, with a particular focus on how these efforts affect Canadian companies given the broad jurisdictional view taken by U.S. authorities. He will look at some enforcement trends of particular note to Canadian companies looking to invest or raise capital in the United States. He also will provide guidance on avoiding avoid liability and best preparing for smooth international transactions and operations.

#### **Moderator**

Susan J. Krembs, Partner, Pepper Hamilton LLP

#### **Speaker**

Gregory A. Paw, Partner, Pepper Hamilton LLP

Register for this complimentary online webinar at <https://www.regonline.com/FCPA>.

### *U.S. Climate Change Legislation*

October 15, 2009 | 12:00 – 1:00 P.M. EASTERN

The clock is ticking, and the Obama administration and Democratic congressional leadership are committed to enacting U.S. climate change legislation in time for the December 7-18 climate change treaty negotiations in Copenhagen. Ms. Luxton and Mr. Walsh are following developments closely as Senate leaders work to get the 60 votes needed for passage, then work out differences with the House bill adopted June 26. Join us for an update and analysis of the prospects for climate change legislation this year and potential effects for Canadian and cross-border businesses.

#### **Moderator**

Susan J. Krembs, Partner, Pepper Hamilton LLP

#### **Speakers**

Jane C. Luxton, Partner, Pepper Hamilton LLP

William J. Walsh, Of Counsel, Pepper Hamilton LLP

Register for this complimentary online webinar at [https://www.regonline.com/US\\_Climate\\_Change](https://www.regonline.com/US_Climate_Change).

### *Operation of Section 892*

It should be noted initially that Section 892 does not impose a tax on any income. Rather, that section confers an exemption from tax for certain income derived from U.S. sources upon which a SWF could otherwise be subject to tax. Thus, in planning for a SWF investment in the United States, the initial analysis is the same as that which would apply to a private foreign corporate entity. Section 892 makes it clear that a foreign government is treated as a corporate resident of its country for both treaty and Code purposes. However, in the case of a treaty, such treatment is conditioned upon reciprocal treatment of the U.S. government by the treaty partner.

The scope of the application of Section 892 is related to a number of factors, including the type of income earned, the source of the qualifying income and the recipient of the income. Thus, Section 892, by its terms, applies only to an integral part or a controlled entity of a foreign government. Furthermore, it applies only to income from U.S. investments limited to stocks, bonds or other domestic securities, bank deposits, or financial instruments held in the execution of governmental financial or monetary policy.

It should be noted that there is a brewing tax policy debate in the United States over whether to repeal Section 892, with noted economists lining up on each side of the issue.

### **Conclusion**

There is growing discussion in India over the wisdom and means of attracting and strengthening India's claim to investment by SWFs. Hopefully, the experience of the United States and its policy determinations will provide a useful guide for India in its deliberations.

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## **Peppercast: Prevent Litigation Before Entering A Major Transaction**

Transactions that are affected in down markets tend to attract litigation – either by stockholders or competing bidders at the outset, or when one party seeks to get out, or after market conditions have improved and second-guessing sets in.

In this podcast, Pepper attorneys Roger A. Lane and Courtney Worcester, members of the firm's Commercial Litigation Practice Group and residents of Pepper's Boston office, discuss an interesting issue in these trying economic times: how to prevent litigation before entering a major transaction.

Listen today by visiting the Commercial Litigation section of Pepper's podcenter at [www.pepperpodcasts.com](http://www.pepperpodcasts.com).

## WEBINAR: FCPA Effect on Business in India

On October 20, Pepper partner Gregory A. Paw and Omar McNeill, general counsel from Freeh Group International will discuss enforcement efforts under the U.S. Foreign Corrupt Practices Act, with a focus on how these efforts affect companies doing business in India. They will look at enforcement trends significant to companies looking to invest or raise capital in India, and due diligence investigation in India. They also will provide guidance on avoiding liability and best preparing for smooth international transactions and operations.

### Moderator:

Valérie Demont, Partner, Pepper Hamilton LLP

### Speakers:

Gregory A. Paw, Partner, Pepper Hamilton LLP  
Omar McNeill, General Counsel, Freeh Group International

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### *Climate Change, continued from page 2*

threatened can reduce avoidable losses of polar bears. But it should not open the door to use the ESA to regulate greenhouse gas emissions from automobiles, power plants, and other sources. That would be a wholly inappropriate use of the Endangered Species Act.”

### Conclusion

Regardless of this concurrence on intentions, the April-May determinations limits consideration of greenhouse gases in consultations relating to polar bears, but not regarding other species listed because of climate change factors, such as elkhorn and staghorn corals and the black abalone. The ESA has long been a notorious litigation magnet, and this recent split decision does not appear to have hindered the ability of those who see it as a useful tool for advancing larger climate change policy objectives, targeting unwelcome CO2 emitting facilities and projects wherever they are.

*This column was adapted from Ms. Luxton's paper in the Washington Legal Foundation's Critical Legal Issues Series (Number 166, July 2009). Visit [http://www.pepperlaw.com/pdfs/072409JaneLuxton\\_WLFarticle.pdf](http://www.pepperlaw.com/pdfs/072409JaneLuxton_WLFarticle.pdf) for the original paper.*

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