

## message from partner in charge

As we look back on the second quarter, the New York office has hired of counsel Russ Adler (Labor), and partners Valérie Demont and Susan Krembs (Corporate and Securities), Richard Reibstein (Labor), Bill Wagner (Financial Services) and associate Abigail Bowen (Health Effects Litigation), despite the turbulent economy.

In this issue, Ms. Demont and Ms. Catanzarite write about the changing face of foreign investments in businesses in India and how the changes may not yet be permanent.

In an online seminar, Ms. Demont, Mr. London and I will participate in a August 5 webinar addressing recent trends in shareholder activism and reasons why directors and management should be proactive.

And we report that merger and acquisition activity is likely to increase this year because of the high level of distressed debt, according to a study commissioned by Carl Marks Advisory Group LLC and Pepper. We're hosting a webinar on this topic; see [http://www.pepperlaw.com/webinars\\_update.aspx?ArticleKey=1538](http://www.pepperlaw.com/webinars_update.aspx?ArticleKey=1538) for details.

James D. Rosener  
212.808.2717  
[rosenerj@pepperlaw.com](mailto:rosenerj@pepperlaw.com)

## in this issue

- 1 **Foreign Direct Investment in India: Are We Facing Another Case of 'Flip-Flop'?**
- 2 **Addressing Recent Trends in Shareholder Activism: Directors and Management Should be Proactive**
- 3 **Market Conditions to Produce Significant Distressed M&A Opportunities in Second Half of 2009**
- 4 **Upcoming Events**

## Foreign Direct Investment in India: Are We Facing Another Case of 'Flip-Flop'?

The Congress Party's surprise victory in India's recent parliamentary elections has ushered in a strong surge in confidence in the Indian economy, resulting in an unprecedented 17.3 percent stock rally in the Indian capital markets that has caused those markets to rise 48 percent to date this year. Based on the Indian government's five-year track record under Prime Minister Manmohan Singh's leadership, the re-election of the Congress Party promises continued economic reforms in India and further opening of its economy to foreign investments.

At the forefront of these measures is the expected continued relaxation of the foreign direct investment (FDI) regime in India. Under the current regime, foreign direct investment in Indian companies is subject to sectoral limitations by industrial sectors, with foreign investments of up to 100 percent permitted in certain sectors (e.g., transportation infrastructure, electricity, pharmaceuticals) down to limits of up to 26 percent in others (e.g., insurance, defense, television news channels).

In February 2009, India's Ministry of Commerce and Industry amended certain guidelines for computing foreign direct investment in India by issuing Press Notes 2, 3 and 4 (2009). While these amendments significantly increased the ability for foreign direct investment in India through step-down joint ventures, they have been faced with fierce criticism from, among others, the Reserve Bank of India and the Indian Finance Ministry's Department of Economic Affairs, which have raised objections to these Press Notes on the basis that they raise the possibility of "circumventing the definition of ownership and control by downstream investments" in sectors in which FDI is prohibited, government approval is required or sectoral caps are in place. Indeed, soon after the Press Notes were issued, companies like retailer Pantaloon and media house UTV have restructured their operations to increase FDI in their businesses through step-down joint ventures.

It is anticipated therefore that these Press Notes will be altered significantly in the near future. It is unclear, however, whether this will result in a return to the regime in place before these Press Notes were issued, or will simply result in ironing out some of the creases the Press Notes created. Yes, this could be another case of “flip-flop.” Before the Press Notes were issued, the amount of FDI in an Indian company for purposes of determining compliance with the FDI sectoral caps was determined by aggregating all foreign direct and indirect investment in the company. If an Indian company was owned by successive holding companies or joint venture partners, the aggregate amount of foreign direct investment in each of those holding companies or joint venture partners had to be taken into account in determining the total amount of FDI in the Indian company.

For example, assume Indian company A&C (“investee” company) is 75 percent owned by Indian company A and 25 percent owned by Indian company C (“investing” company) and Indian company C is itself 20 percent owned by foreigners and 80 percent owned by Indians. 25 percent of the 20 percent foreign ownership of Indian company C would be considered foreign indirect investment in Indian company A&C in order to determine its compliance with the FDI sectoral caps.

In February 2009, the Indian government sought to relax those rules and permit greater foreign direct investment in the country by proposing that, except in case of sectors governed by special statutes, foreign direct investment in an “investing” company in India will not be attributed to the “investee” company in India for the purpose of determining such “investee” company’s compliance with the FDI sectoral caps; provided that the “investee” company is owned<sup>1</sup> **and** controlled<sup>2</sup> by Indian resident citizens directly or through companies incorporated in India. Equity investments routed through companies in which majority ownership and control of the board is in the hands of Indians would be treated as fully Indian entities. Therefore in our example above, if company C is owned **and** controlled by Indian resident citizens, then company C’s aggregate total investment in company A&C will be considered as pure Indian investment as a whole and no amount of foreign investment in company C will be attributed to company A&C for purposes of determining compliance by company A&C with FDI sectoral caps. The old principle that direct investment by an entity not incorporated in India into an Indian company will continue to be treated as FDI.

## Addressing Recent Trends In Shareholder Activism: Directors and Management Should be Proactive

August 5, 2009

12:00 – 1:00 P.M. EASTERN

Join us for a complimentary, one-hour online seminar that will focus on the trends in shareholder activism, recent developments in Delaware corporate law, the SEC’s proposed regulations on proxy access, the current status of poison pills and recommended actions for directors and management.

### Speakers

Valérie Demont, Partner, Pepper Hamilton LLP

Richard De Rose, Managing Director,  
Houlihan Lokey

Steven R. London, Partner, Pepper Hamilton LLP

James D. Rosener, Partner, Pepper Hamilton LLP

Register online at

[https://www.regonline.com/Shareholder\\_Activism](https://www.regonline.com/Shareholder_Activism) or  
contact Brian Dolan at [dolanb@pepperlaw.com](mailto:dolanb@pepperlaw.com).

Additionally, the Press Notes also clarified that foreign institutional investment (FII) in Indian companies will no longer be included in the computation of FDI for the purposes of determining compliance by such companies with their sectoral caps.

The Press Notes also clarified that in sectors subject to caps (i.e., not open to 100 percent foreign investment) approval from the Foreign Investment Promotion Board of India (FIPB) will be required for the establishment with foreign investment of any company in India that will be owned or controlled by a non-Indian entity and for the transfer of ownership or control of an Indian company that is owned or controlled by Indian parties to non-Indian parties, through a share transfer, merger, amalgamation, etc. Before the Press Notes were issued, the transfer of shares from Indian parties to non-Indian parties, including acquisition

of shares in an existing company, did not require FIPB approval.

The Press Notes also restricted the instances in which FIPB approval will be required for downstream investments by foreign-owned or -controlled Indian companies only to downstream investments made by foreign-owned or -controlled Indian companies that are not operating companies (e.g., holding companies or investing companies). Previously, all Indian companies that were either foreign-owned **or** -controlled required approval from the FIPB before they could make further downstream investments in India. Under the new Press Notes, a foreign-owned **or** -controlled Indian company that *operates* a business will not require FIPB approval before making investments in yet another company, as long as the sectoral caps guidelines discussed above are satisfied. This exemption will remain even if the operating company also has investments so long as investments are incidental to its operations. This will make it much easier for domestic companies to invest in other domestic companies.

The Press Notes are a huge step for India in terms of liberalization of foreign policy. Loosening the regulatory control on FDI investments for certain investment

structures and eliminating the differential treatment between Indian companies who have FDI and those that do not have FDI, if the ownership and control conditions are met, will greatly facilitate the inflow of additional FDI into India. However, there still looms the possibility that these Press Notes may be overhauled to appease the objections of the Reserve Bank of India and others resulting in another case of “flip-flop.”

*Authors:*

*Valérie Demont*

212.808.2745

*demontv@pepperlaw.com*

*Janaki Rege Catanzarite*

215.981.4532

*catanzaritej@pepperlaw.com*

#### Endnotes

- 1 “Owned” generally is expected to mean more than 50 percent of the equity interest in the Indian company.
- 2 The definition of “control” for purposes of these regulations remains unsettled. It is generally expected to mean the power to appoint the majority of the board of directors.

## Market Conditions to Produce Significant Distressed M&A Opportunities in Second Half of 2009

The current economic downturn will offer greater discounts on distressed assets than previous downturns have offered, drawing both financial and strategic buyers to the market in the coming months, according to 92 percent of respondents to a new **Distressed M&A Outlook** survey conducted by mergermarket, Carl Marks Advisory Group LLP and Pepper Hamilton LLP.

In the second quarter of 2009, Carl Marks Advisory Group LLP and Pepper Hamilton LLP commissioned mergermarket to survey 75 investment bankers, private equity practitioners, hedge fund investors and lawyers regarding their outlook for distressed M&A activity in the upcoming year. Respondents provided invaluable insight into current market conditions, as well as a forecast for the year ahead.

“With a variety of factors contributing to an increased volume of distressed opportunities, both buyers and sellers are expected to eagerly pursue deals, as each side stands to gain unique benefits,” said Jim Rosener, managing partner of the New York office and head of the International Practice Group at Pepper Hamilton LLP.

Aside from attractive discounts, debt-related issues will likely be the most prominent drivers of distressed M&A activity in the upcoming year, according to respondents. An increase in covenant defaults is identified as a major catalyst to distressed deal flow, as is companies’ inability to meet debt obligations or refinance upcoming maturities.

Distressed investors are likely to find the greatest opportunity in the following two sectors:

- Real Estate, where 63 percent of respondents expect to see the highest volume of distressed deals in the year ahead, and
- Financial Services, which 38 percent of respondents believe will experience the highest volume of distressed M&A this year.

63 percent of respondents expect most distressed deals to be handled outside of court; however, Chapter 11 reorganizations may be an exception as these are expected to be extremely common over the next 12 months.

The predominance of out-of-court deals is likely related to time constraints, as many respondents cite time as a major drawback to handling deals in court. 59 percent of respondents say the distressed M&A process can exceed four months when handled in court. Meanwhile, on cases handled outside of court, only 25 percent of respondents say the process can take this long. “If implementable, out-of-court solutions are generally less expensive and disruptive. However, it is not clear whether companies with complex capital structures will ultimately be able to obtain all of the consents necessary to use these solutions,” explains Duff Meyercord, partner at Carl Marks.

Time constraints also are expected to put pressure on management teams within distressed companies, which in turn may influence the dynamics of distressed transactions going forward. According to Jim Rosener, “Not only is the market characterized by people having to do something and forced to do it on a tight timetable, but there also is an increased opportunity as management loses focus and interest over these orphaned businesses.”

Additional findings:

**Exit outlook:** 65 percent of respondents plan to delay their exits from distressed investments in the upcoming year.

**Valuations:** 54 percent of respondents say asset-based valuations tend to be the primary determinant of price.

**Alternative strategies:** 79 percent of respondents expect debt buy-backs to increase in the year ahead.

**If you would like a copy of this report, please contact Brian Dolan at 215.981.4568 or [dolanb@pepperlaw.com](mailto:dolanb@pepperlaw.com).**

## Upcoming Events

### The EACC-NY Mid-Year Networking Breakfast

July 22, 2009

The Cornell Club of NYC

7:30 a.m. – 9:30 a.m.

Register by visiting [www.eaccny.com](http://www.eaccny.com).

### Hedge Funds: What’s Happening Now? Roundtable

July 28, 2009

Pepper Hamilton LLP | New York, NY

Pepper presenters will focus on sovereign wealth investments, securities and tax issues related to distressed debt purchases and holdings and investment opportunities in India. To register, contact Lucy Nelson at [nelsonlj@pepperlaw.com](mailto:nelsonlj@pepperlaw.com) or 212.808.2730.

### BKR International 2009 Annual Worldwide Meeting

October 24-27, 2009

Waldorf Astoria Hotel | New York, NY

James D. Rosener will participate on a panel during their 2009 annual meeting discussing the elements of doing business in the United States. For more information visit [www.bkr.com](http://www.bkr.com).

## Pepper Hamilton LLP

Attorneys at Law

The material in this publication is based on laws, court decisions, administrative rulings and congressional materials, and should not be construed as legal advice or legal opinions on specific facts. The information in this publication is not intended to create, and the transmission and receipt of it does not constitute, a lawyer-client relationship.

Please send address corrections to [phinfo@pepperlaw.com](mailto:phinfo@pepperlaw.com).

[www.pepperlaw.com](http://www.pepperlaw.com)

Berwyn | Boston | Detroit | Harrisburg | New York | Orange County  
Philadelphia | Pittsburgh | Princeton | Washington, D.C. | Wilmington

© 2009 Pepper Hamilton LLP. All Rights Reserved.  
This publication may contain attorney advertising.