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Navigating risk

7 July 2015

The changing face of Africa

How investors are deploying robust tools to manage risk

Challenged by centuries of cultural bias and a tendency for investors to obsess with perilous downside risks or overhyped prospects, Africa is a continent that naturally polarises opinion.

But as a number of its states exhibit the green shoots of democratic stability (Nigeria's presidency passed peacefully from one elected president to another on May 27th 2015 for the first time in its history), sustainable growth and rising scores against benchmark indices for business risk, investors are engaging with Africa's institutions and using a range of legal instruments which secure and protect the opportunities this continent has on offer.

For decades its regions have offered riches largely drawn from natural resources alone, but today's cycle of growth may be different from those preceding it. While energy and resources remain the dominant assets, dialogue amongst the international investment community has slowly turned towards the creation of infrastructure and industrialisation, building supply chains and creating jobs for African people. The United Nations Economic Commission for Africa 2014 Report pointed to the fact that with very little industrialisation, the continent still managed to deliver 5% annual growth for a decade, but that if it is to rid itself of exposures to volatile commodity prices (five exports account for 64% of the total)[1] policymakers should enable much greater global trade in manufactured goods, where its share is a measly 3.3%.

With the macro-economic picture showing positive signs, the regional and country-wide perspective can also deliver hopeful noises. One of the most important measures for international investors, the World Bank's Ease of Doing Business Index, has reported a quickening of the pace of regulatory improvements across Sub-Saharan Africa in recent years. It indicates that in 2006 a third of Sub-Saharan African economies made improvements to the regulatory climate for domestic firms; however, between June 2010 and May 2011, this proportion rose to 36 out of 46 (78%) governments in the region implementing reforms in at least one of the 10 areas measured by the report.

Observers of the index will acknowledge that there remains some way to go for Africa's institutions and markets. Most of its economies rank towards the bottom of the World Bank's list, and powerhouses like South Africa are showing signs of a protectionist agenda. However, one of the key differences between today's African growth story and historic examples where economies faltered, is the availability of freely accessible data which provides insight into the dynamics of business, regulation, legal oversight and many other factors. With these resources investors can build a more informed picture about essential concerns such as the enforceability of contracts; how simple it is to obtain construction permits and licences, maintain a steady supply of electricity or simply start up a business in the first place.

Risk assessment: Data at your fingertips

As shown by the World Bank example, investors can now perform desktop risk assessments from an ever growing choice of trusted sources. Ratings agencies provide credit scoring and analysis of sovereign economies, while corruption indices probe governments and institutions to provide a picture of the challenges investors may encounter.

Chief amongst the latter is Transparency International, whose Corruption Perceptions Index provides the best known resource for researchers, analysing states' governance and development indicators including judicial independence, the rule of law, press freedom and the propensity of its people to pay bribes.

However, there is no substitute for knowledge and experience and while the above generally represent a healthy back catalogue of research material, local understanding of individual countries' culture, practices and institutions is a must for investors. From a legal point of view, the risks are broad, but none illustrates the potential problem better than the fact that contractual obligations may simply get lost in translation without the right interpretation.

CMS Partner Omar Qureshi explains: "This is true of all international investment or transaction negotiations, but it's absolutely vital you have good local lawyers. Your idea of a material breach of contract might be very different from your contracting party, so don't just say 'you can terminate if there is a material breach' and leave it at that; define what those breaches are before you agree the terms. You don't want to end up in a dispute just because the contract was unclear. This is particularly vital when dealing with international counterparties."

1 Source – African Centre for Economic Transformation

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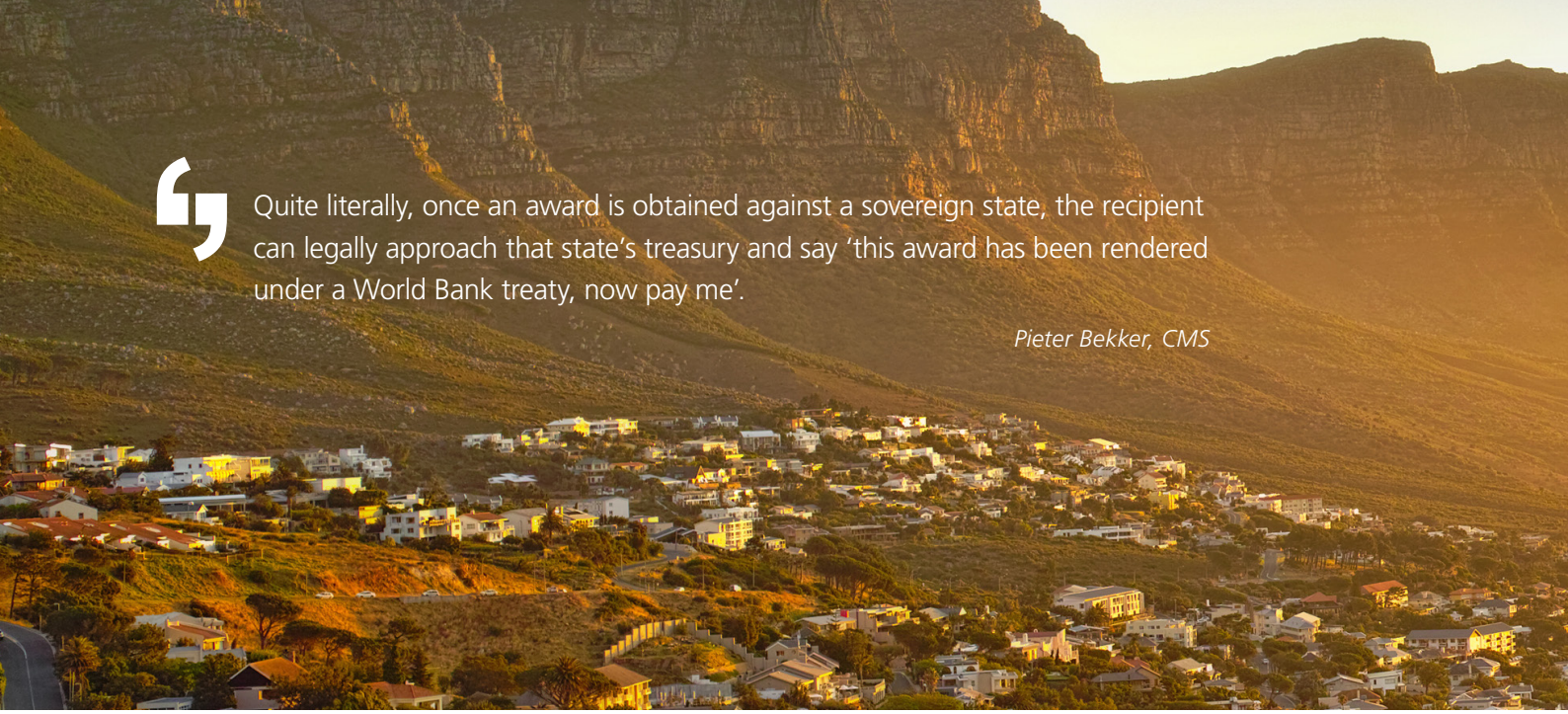
>
> *Omar Qureshi, CMS*

Highly corrupt — **Very clean**

0-9 | 10-19 | 20-29 | 30-39 | 40-49 | 50-59 | 60-69 | 70-79 | 80-89 | 90-100

Source: Transparency International: Corruption Perceptions Index 2014



> Quite literally, once an award is obtained against a sovereign state, the recipient can legally approach that state's treasury and say 'this award has been rendered under a World Bank treaty, now pay me'.
>
> *Pieter Bekker, CMS*

Risk mitigation – Building in contractual protections

With public data sources broadly establishing the typical risk factors investors can face, there are a variety of mitigation techniques available, many of which can be codified into a set of enforceable contract terms with a clear objective; either the right to claim for damages or equally, to be able to walk away clean.

These risks have a habit of grabbing headlines, such as threats against the safety of personnel or events which may damage an investor's reputation and goodwill. However, it is essential to consider in contractual terms what to do if a pre-defined trigger occurs.

"A good example would be terms dealing with anti-bribery controls," says Omar Qureshi. "You would expect to see warranties in the contract that individuals won't bribe in connection with the contract and you should have a right to terminate if they do. You would also expect the contract to require confirmation that counterparties have their own internal anti-bribery controls which are effective and kept under review, or that they promise to comply with yours. To enable the latter, there would be further provisions to ensure that the counterparties have the ability to comply with your controls, for example making sure that they have copies of your key policies and that they take the training courses that you provide to your own staff. To ensure compliance, one might include wide rights to audit that compliance, with access to data, documents and employees of counterparties involved in working for you. There may even be an annual certification of anti-bribery controls or an indemnity provision if there is any breach."

Business is business

With sovereign states or their agencies and instrumentalities frequently counterparties in international investment projects, the contractual role of state parties is a major consideration. In short, they should always be treated as commercial parties because the tactic of claiming sovereign immunity can simply be too tempting in a dispute. For example, at the top of the risk register when dealing with sovereign counterparties will be expropriation of assets, a practice recently made internationally famous by the actions of governments like Venezuela and Argentina and habitually since the early 1980s by the government of Zimbabwe. In May 2015 Venezuela successfully claimed sovereign immunity, albeit in a dispute with a domestic investor, the expatriate billionaire Nelson J. Mezerhane, who sued his homeland in US courts for alleged illegal expropriations. In this instance Mezerhane's action failed as US law seeks to encourage foreigners to fight their own governments on their own soil.

Mr Mezerhane's travails provide a helpful example of why investors seek out extra-contractual protections which can serve to level the playing field before a contract is signed. Where possible, an increasing number look to have any potential dispute governed by arbitration rather than litigation, so that parties can be assured of a fair hearing and a transparent procedure without the possibility of protracted litigation.

For the most part, western companies are likely to choose traditional arbitration centres such as the LCIA in London or the ICC in Paris, but African states have also embraced arbitration and have created centres in the hope that parties will allow their cases to be heard on African soil. For example, Rwanda launched the Kigali International Arbitration Centre in 2012 to much fanfare, promising efficient dispute resolution throughout East Africa in a move which seeks to mirror the longer established OHADA membership of 16 mainly francophone African states.

Enforcement via treaty

Ultimately, investors are seeking a universally enforceable contract with the most favourable terms possible and for this to be achieved, says Pieter Bekker, an international law professor and Partner at CMS, you must first consider the two key pillars of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and, for investment disputes, the Washington Convention.

"Well over 30 countries in Africa have ratified the New York Convention, which lays down rules directing local courts to enforce arbitration agreements between parties and to provide a mechanism for enforcement of arbitral awards. Essentially it tells those courts that they may only refuse to give effect to an arbitral award on a limited number of grounds, such as the incompetence of the arbitrators or that they may have gone beyond the scope of the parties' arbitration agreement. If you're contracting with a party from a country that hasn't ratified the New York Convention or if you're arbitrating in a country that is not a party to that treaty, there's no guarantee an arbitral award will be recognised or enforced."

The Washington Convention created the International Centre for Settlement of Investment Disputes (ICSID), a World Bank entity. "This has now become the facility of choice for investors, and over 3,000 bilateral and multilateral investment treaties have come into play" says Pieter Bekker. "However, this mechanism only applies to foreign direct investment, so ordinary contracts for the sale of goods or services are not covered. But where it applies, it provides even greater protection than the New York Convention because there are limited grounds for refusing recognition and enforcement of the arbitral awards it delivers. Quite literally, once an award is obtained against a sovereign state, the recipient can legally approach that state's treasury and say 'this award has been rendered under a World Bank treaty, now pay me'."

BIT guarantees and treaty protections

If arbitration is the cornerstone of efficient commercial dispute resolution, then the Bilateral Investment Treaty is arguably the best guarantee of ensuring an effective remedy for investors while providing an alternative to political risk insurance (see page 8).

BITs are the agreements which establish terms and conditions for private investment by nationals and companies of one state in another state. They grant investments made by an investor of one contracting state in the territory of the other a number of substantive guarantees, which typically include fair and equitable treatment, protection from expropriation without compensation, free transfer of profits and full protection and security. They grant procedural guarantees by ensuring parties have recourse to ICSID or another agreed arbitration mechanism and have proven themselves a robust mechanism. For example, Zimbabwe's process of Land Reform began in the 1980s, ostensibly to return formerly communal land to state or tribal ownership. However, having entered into the ICSID Convention in 1991 and numerous BITs with other nations, arbitrations have been brought against the country by foreign investors stung by its policy of expropriation.

In *Bernardus Henricus Funnekotter and others v. Republic of Zimbabwe*, a group of Dutch landowners and farmers initiated ICSID arbitration proceedings against Zimbabwe after being deprived of their property, in violation of the Netherlands-Zimbabwe BIT. The Arbitral Tribunal in that case found in favour of the investors and awarded €8.2m compensation.[2]

2 ICSID case ARB/05/6 http://www.italaw.com/sites/default/files/case-documents/ita0349.pdf

The presence of these mechanisms to support and protect foreign direct investment are established, tried and tested. However, they may not yet be fully understood as one of the best means to secure and protect an FDI project against political risk.

For example, a global survey of 602 executives conducted by The Economist Intelligence Unit for the Columbia Program on International Investment in 2009 posed the following question to participants: 'To what extent does the existence of an international investment agreement (for example, a bilateral investment treaty) influence your company's decision on which markets to invest in?'

Only 19% responded 'To a very great extent', with 48% answering 'To a limited extent', and 23% choosing the 'Not at all' option. A further 9% answered 'Don't know'.

Pieter Bekker says that while these data suggest that BIT protection may be of limited interest to a substantial portion of foreign investors, the tide may be turning.

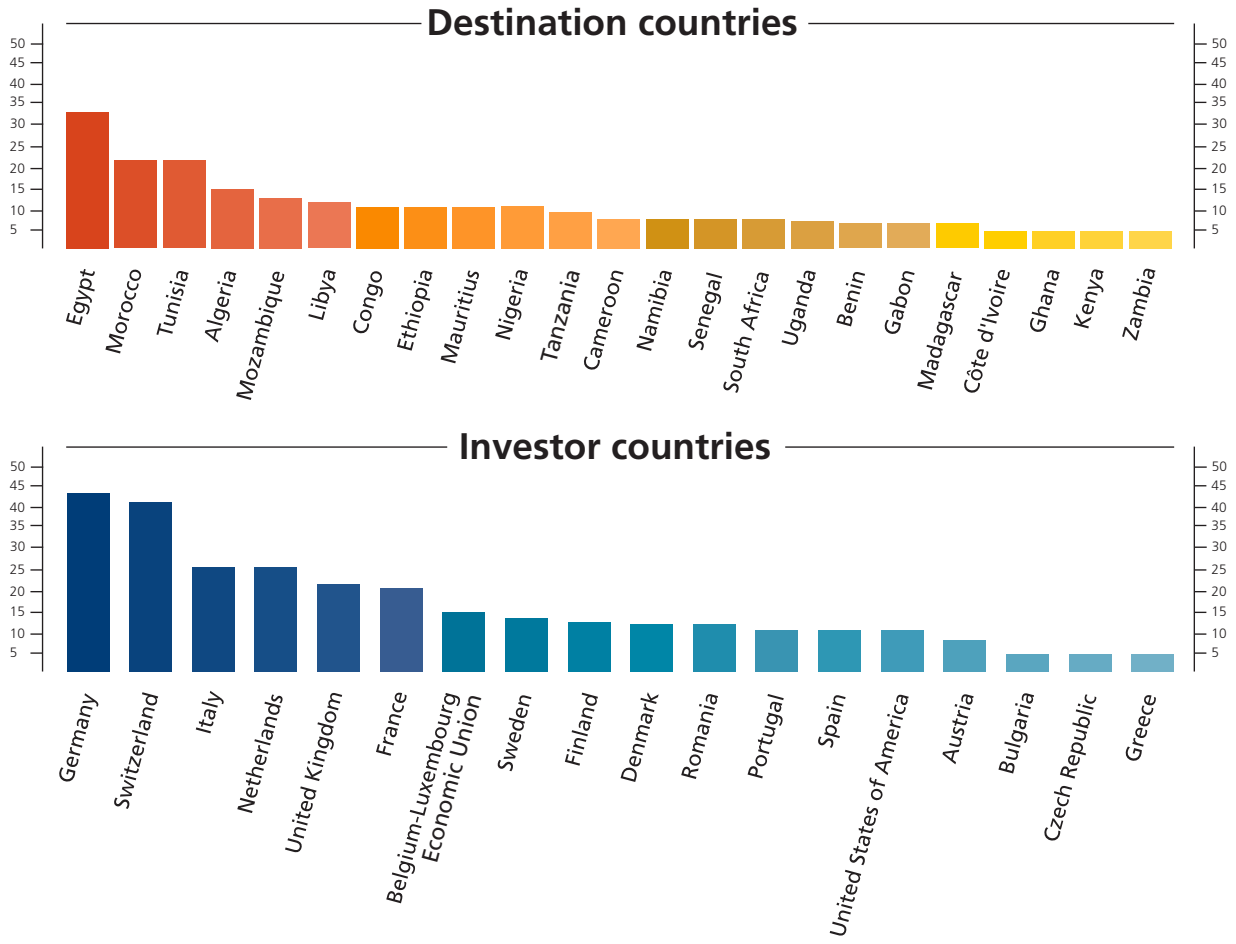
"The rapid increase in investor–State arbitrations based on BITs—a phenomenon that only became prominent in the late 1990s and has been making headlines ever since—and the associated dissemination of arbitral awards obtained by investors against host States, should result in greater investor awareness of BITs as a potentially powerful instrument of political risk mitigation."

The new African frontier

Africa looks set to continue on a path of economic growth. It is being discussed to varying degrees as an alternative manufacturing base for Chinese and Indian companies seeking economies of scale, and the calls for investment in its infrastructure grow louder every day.

The key risk management challenge for investors will be in navigating through the inevitable hype that is likely to surround the whole 'invest in Africa' juggernaut. Thankfully, an international system of legal tools has been imagined and refined over more than 50 years giving you reason to do business in the new frontier with increased confidence.

Prevalence of Bilateral Investment Treaties



Source: UNCTAD International Investment Agreements Navigator (http://investmentpolicyhub.unctad.org/IIA)

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Political risk insurance

The political risk insurance market has enjoyed a surge in supply over recent years. Nick Cook and Gavin White at specialist broker RK Harrison say underwriters will value long-term relationships; even in the least hospitable economies.

The two principal protections on offer from the 45+ insurers offering PRI and credit insurance in the London and international markets are sometimes described as occupying opposite ends of the 'art vs science' spectrum and are distinguished by whether your primary risk or counterparty is a private (credit) or state owned entity or a country (PRI).

A combination of excess capital and a limited number of catastrophic events impacting on reinsurers has led to an estimated 100% increase in PRI and credit capacity since the 2008 global financial crisis meaning that there is over USD 2bn available capacity for any given PRI risk and over USD 1.4bn for credit cover.

Both disciplines support clients, including banks, commodity traders and corporates, depending on their specific need by covering non-payment credit risk, which owes much of its underwriting to analysis of financial models fitting the 'scientific' label. The PRI market, covering risks such as expropriation, confiscation, currency risk and political violence or non-payment by a government entity, requires a 'certain flair', which is a result of extensive experience drawn from working with clients in difficult environments. It should however be noted that in an African context the credit risk will almost always factor in the specific country and political risk. Both areas are enjoying a period of healthy competition and innovation from insurers and only a handful of countries across Africa present genuine problems for underwriters.

For the investor looking into PRI or credit for the first time, parallels of the availability or cost of cover can be drawn with how established and stable governments are across Africa. People who look at Africa for an investment or trade opportunity may be pleasantly surprised at the availability of cover and while there remain some particularly difficult regions even highly challenged countries can be insured for the right types of business. Building a strong partnership with an insurer can mean that an insured can obtain cover in even the most unstable of countries.

Similar to the need for local legal representation, the demand for local knowledge and a good track record will help your insurer and cannot be underestimated. Like any financial service provider, an underwriter is looking for a strong risk management story and investors are encouraged to collaborate with their brokers to bring local knowledge back to the insurer to build on the knowledge base.

Achieving good value on a PRI and credit programme for investments in Africa has never been more possible, but your success is as much of a reflection of your presentation of the risk, as it is about any existing knowledge the insurer may have.

Import/export embargo

Mali 2012 – Total embargo to give power back to the national constitution

Sovereign default

Nigeria 2012 – Forced to restructure USD 3.5 billion of unpaid invoices for state oil product purchases

Political violence, terrorism, war

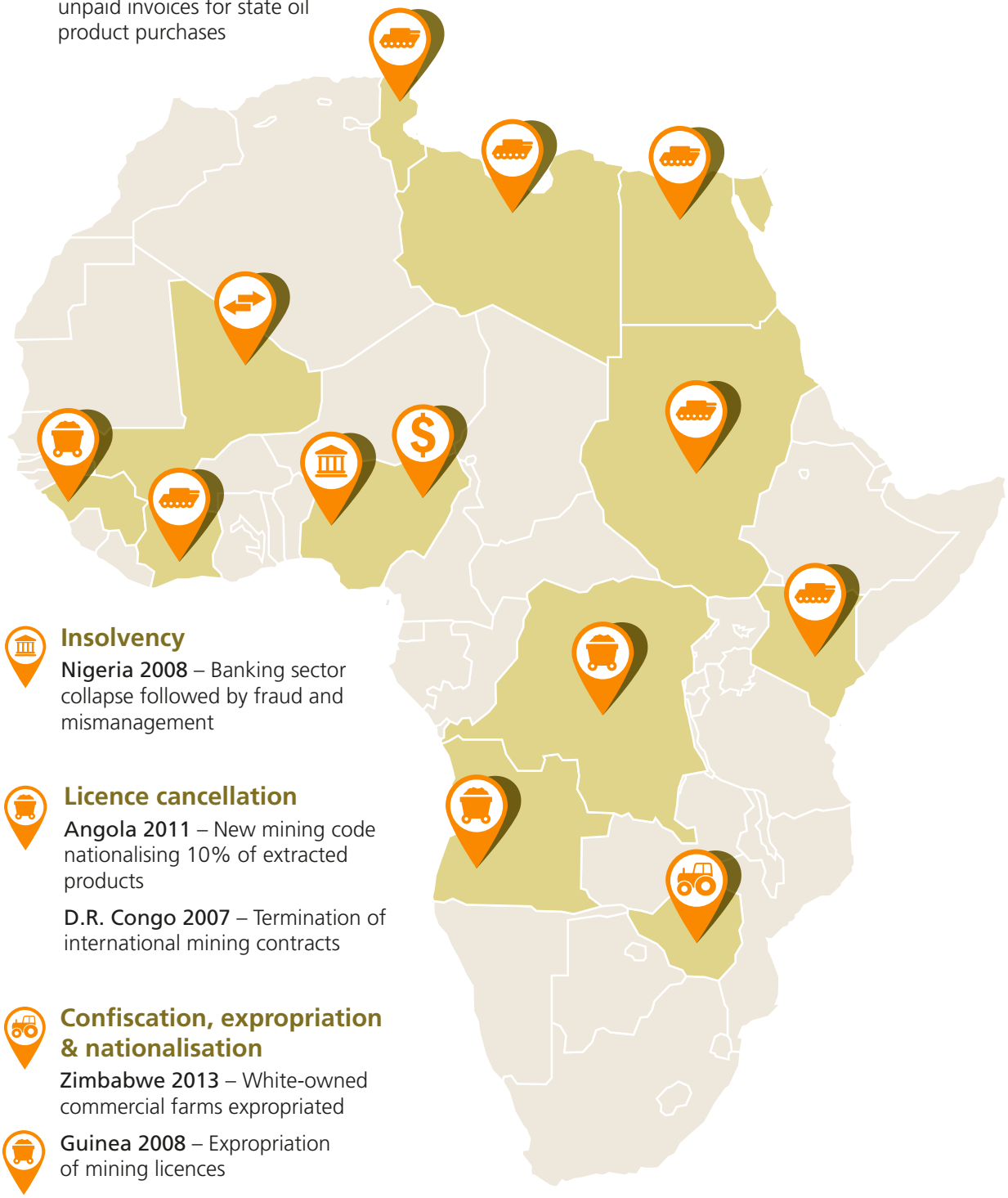
Libya 2012 – Revolution and overthrow of Gaddafi

Egypt & Tunisia 2011 – "Arab Spring" revolutions

Ivory Coast 2011 – Civil war

Sudan 2011 – Splits into North and South following bloody civil war and ongoing disputes

Kenya 2008 – Kenyan civil unrest and genocide



Insolvency

Nigeria 2008 – Banking sector collapse followed by fraud and mismanagement

Licence cancellation

Angola 2011 – New mining code nationalising 10% of extracted products

D.R. Congo 2007 – Termination of international mining contracts

Confiscation, expropriation & nationalisation

Zimbabwe 2013 – White-owned commercial farms expropriated

Guinea 2008 – Expropriation of mining licences

Source: RKH Financial Risks (http://www.rkhgroup.com/polrisk.html)

Today's panelists

Nick Cook,
Account Director, RKH Specialty
Nick has been working as a broker in the Political Risk and Structured Credit insurance market for over 9 years working with bank, trader and corporate clients to provide insurance solutions to mitigate political and credit risk across a broad range of underlying assets and contracts. Nick heads up the wholesale team working with producing brokers and clients from round the world and is involved in the negotiation, placement and management of large, multi-country bespoke placements.

Tim Hardy,
Partner, CMS
Tim handles both domestic and international disputes primarily relating to finance and commerce. He has recently been representing a Claimant in an Investment Treaty arbitration under the ICSID Additional Facility brought against the State of Montenegro. He is a Fellow of the Chartered Institute of Arbitrators, a member of its Board of Management and Chair of its Practice & Standards Committee. He is also a member of CEDR's Select Panel of Mediators and a Solicitor-Advocate (Higher Courts Civil). Tim heads up CMS's Commercial Disputes Team.

Simon Kilgour,
Partner, CMS
Simon acts for domestic and overseas insurers and reinsurers on complex, high value or non-standard coverage disputes or market issues. His work is mainly international and includes advising on wordings, inspections, inwards & outwards coverage disputes and commercial and corporate work relating to the conduct of (re)insurance companies. Simon is a leading innovator of online contract checking solutions and was named as one of the leading reinsurance lawyers in Europe in an international survey of in-house counsel by Bermuda: Re magazine.

Bob Palmer,
Partner, CMS
Bob is Head of the Oil & Gas Team at CMS UK and he has specialised in advising companies in the oil and gas industry for over 25 years. As well as a significant practice in the UK, much of Bob's work is in Europe, the Middle East, South Asia and, particularly, throughout Africa. He is listed in Band 1 by Chambers for Energy & Natural Resources and as a leading individual by Legal 500. Bob is a recognised expert in the industry and is quoted in Legal 500 2014 as "an industry leader - one of the top in his field".

Omar Qureshi,
Partner, CMS
Omar leads the firm's corporate crime team. He specialises in corporate investigations, compliance and commercial disputes, often involving allegations of fraud, money laundering and corruption. He is currently advising clients in connection with ongoing internal and external corruption investigations, money laundering issues and in developing procedures to meet the requirements of the Bribery Act 2010. He is recognised in Legal 500 for his "incredible attention to detail" and as "client focused", "extremely knowledgeable" and "smart and commercial".

Jamie Simmonds,
Chief Executive Officer/ Managing Director of The Access Bank UK Limited
Jamie has enjoyed a career spanning 38 years in financial services, holding a series of director roles for National Westminster, Coutts, Royal Bank of Scotland, Gerrards and Close Brothers. He has a proven track record in the start-up and turnaround of financial service businesses, delivering sustainable benefits for all stakeholders. He has extensive knowledge of both Corporate, Retail and Private Banking services. Jamie is an alumnus of Harvard Business School Executive Management Programme, an Associate of the Chartered Institute of Bankers and a Certified Financial Adviser.

Gavin White,
Account Director, RKH Specialty
Gavin started his career with Arthur J Gallagher in 2006 before joining RK Harrison's Political Risk and Structured credit team in 2011. His current role is as Account Director of a large bank client which has a long standing relationship with the Political Risk and Structured credit market, managing the placement of a wide variety of risks across different products and sectors globally. Previous clients have included traders and large corporate clients.

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