Emerging Markets
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The bi-annual newsletter of international and local legal considerations for investors in and from Africa

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Welcome to Issue 10 of our Emerging Markets Newsletter, focussing on Africa.

This issue highlights a broad range of hot topics that are focussing the minds of investors looking to tap into the growth potential of Africa. We look at the legal requirements that affect investors and aim, with the support of our partners, to provide up to date analysis across the continent.

This time we look at exits, financing structures for reserve based lending in the UK compared to Nigeria, Cameroon, Ghana and Uganda, pension fund reforms for private equity investment in key jurisdictions such as Nigeria, South Africa and Kenya, foreign exchange rules in Angola, up to date analysis of the changing legal framework in Kenya and Zimbabwe, a focus on the MENA region with consideration of certain legal issues involved in construction projects, private equity fundraising and investment in offshore cable projects, together with our usual mix of updates and comments on key legislative reforms.

For Private Equity, 2012 in Africa was a good year for investments and exits. With funds looking to raise new capital, whilst at the same time close exits from their existing portfolios, 2013 looks like it could deliver an increase in activity, particularly later in the year.

Governments have recognised the need for inward investment, particularly in certain sectors, but continue to look to protect local needs to try and fuel sustained local growth and wealth. The strive for a successful win-win balance between these needs continues to be the goal of all those involved.

The fundamentals have not changed significantly and some new players, both overseas and locally, have emerged. We continue to be busy advising existing and new clients on a variety of complex and innovative transactions, including a wide variety of fundraisings, investments, M&A and Energy & Infrastructure Projects, right across the continent and look forward to continuing to do so throughout 2013.

I would like to take this opportunity once again to personally thank all our contributors for their work in producing this edition and for supporting us and partnering us in our work in Africa.

If we can be of assistance, then please do not hesitate to contact us.

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Private Equity Exits in Africa

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Private equity exits in Africa are in the spotlight. In order for a fund manager to differentiate itself from its competitors and raise first time funds or follow on funds, a successful track record can be critical. Ultimately, a successful track record is a function of successful exits. As many investors would agree, "the trick in private equity is not investing, it is divesting".[1] The exit is, therefore, something that preoccupies the minds of fund managers from the very beginning of the investment process.

There are a number of private equity funds in Africa which have not exited a number of their investments, but are approaching their agreed duration and the private equity house would like to raise a follow on fund for continuance of its investment in its pipeline of deals. A typical African fund's duration is 10 years with the ability for 1 plus a further 1 year extension requiring advisory committee and investor consent at varying levels. This is generally a lengthier period than in European or US private equity. Desirable periods for funds to hold portfolio companies before an exit is typically three to four years,[2] but this may need to be longer in Africa, where strategies typically take longer to implement, particularly when cross border.

Extensions are typically given but are not desirable. Therefore, whether it is a first time fund or a follow on fund, it is the concerns surrounding the potential for exits that is attracting the attention of private equity funds and their investors. Principally, as the potential for a large capital gain on exit is what drives almost all private equity investment, achieving a viable exit route is key.

In the emerging market economies in Africa (excluding South Africa which has a more robust exit environment and strong stock exchange), particularly where there may be difficulties with local exchanges for IPOs and a perceived lack of trade or other buyers, fund managers pay even more attention than usual to exists. The willingness of a fund manager to consider creative exit solutions may ultimately set it apart from the competition, as will astute structuring at the outset, which should also pave the way for an efficient exit when the time comes.

As for timing, there is a decision to be made between first, achieving an early exit at a particular valuation and alternatively allowing the business to mature and increase in value over time, but private equity investors will generally prefer the certainty of an earlier exit to the prospect of a higher valuation later. The management's view may be very different as an exit is usually life changing for the manager, either from a financial point of view or that he may end his career early or be given increased responsibility and profile within a new, possibly listed, group. Exit transactions are also time consuming and a distraction from a manager's routine work activities, are likely to involve increased exposure to liability through warranties and ultimately restrictions on his ability to find other work if restrictive covenants are negotiated. Given all of the above, it is important to agree upfront and document the intentions for exit together with the rights and responsibilities of the parties.

Alternative Types of Exits

Apart from an IPO (not usually a full exit as the investor will typically be required to retain a stake in the issuer and be locked in for a certain period) and a trade sale to a strategic buyer, there are other ways for the private equity fund to generate an exit, as described below (although not exhaustive).

A significant trend in Europe and the US is the development of a market for secondary or portfolio transactions, being the whole or part sale of a portfolio of fund investments rather than an exit on an asset by asset basis. Such secondary transactions usually carry a discount of 10% to 15% of market value but this will depend on the quality of the underlying investments and the private equity seller. The benefit to the private equity fund is that it can exit a number of assets, usually quicker and less costly (save for the discount) than a sale of each company individually. Secondary transactions have been rare in Africa but the market may develop given the difficulties with the duration of funds and the number of portfolio companies that need to be exited as described above.

Secondary transactions should not be confused with secondary buyouts where a private equity fund would sell individual portfolio companies to another private equity fund and usually the existing management. An example of a secondary buyout in Africa in 2012 is the sale by Aureos of Golden Lay, the Zambia based agribusiness, to Phatisa, for a reported $24 million.

The market for secondary buyouts in Africa is expected to increase given the change in the dynamics of the private equity market as a result of some of the larger global funds raising Africa specific funds or hiring teams with an African focus for the deployment of asset allocation from their global pools of capital. Examples are Carlyle, KKR

and the merged Abraaj and Aureos group with capacity to carry out larger transactions and secondary buyouts in Africa, which offers exit opportunities for the earlier players who have built larger businesses for exit. There are also the larger more established players such as Actis, Ethos, Brait, Citadel and Helios who are all capable of transacting at such levels.

Another exit strategy involves the break up and distribution of proceeds of the sale of parts of a larger group with two or more diverse businesses that were originally acquired, restructured and developed to the extent that the sum of the parts is worth more than the group as a whole. In Africa, there are large conglomerates or family controlled groups holding multiple businesses where a potential for this strategy exists. If originally acquired on a "bulk discount", this strategy could prove successful for innovative private equity groups who are able to identify the most suitable trade buyers for the repackaged businesses at the outset.

The redemption of preference shares is another exit route where the private equity house is able to extract the majority of its initial investment, provided the business is successful and has been able to generate cash flow. This could be done at a small premium if the result is that the management team obtain control. If the business is not succeeding, the redemption would allow the extraction of unspent cash rather than investing it further in a failing business. Preference shares would need to have been issued at the outset in contemplation of this option.

In other cases, exits may be engineered. If the underlying business is highly cash generative it could be refinanced to repay investors or make use of a securitisation structures. However, the current global economic climate and scarcity of debt is not conducive to these sorts of transactions, particularity in Africa, although they may occur on a small scale or in more developed jurisdictions.

If the business holds a significant portion of its value in property (for example, hotel or retail groups), sale and leaseback transactions could be used to generate cash to return to investors, whilst still being able to operate the underlying business through long term leases.

The use of put options could also be considered where an upfront contractual right to sell the shares to the other party is agreed, subject to determination of the price at the appropriate time.

Private equity funds also consider certain instruments that pay a coupon or generate regular interest payments as a means to extracting value through the life of an investment. This partial exit is a means to reduce the risk of a delayed or undervalued exit. These instruments are typically corporate bonds or junior debt convertible into equity.

Exits in Africa in 2012

As recently reported,[3] exit volumes in African private equity hit a high in 2012 delivering 14 exits, the highest number since 2006. This also represented a 40% increase on the 2011 figures. Although, a relatively minor percentage of global private equity exits, it represents a favourable trend for the moment, which could start to allay the concerns of private equity investors that exits may not be easy to execute. The total value of exits for 2012 are not insignificant at $1.65 billion, which represents an increase year on year of 13%.

These figures are based on captured data only and may not represent all of the transactional activity in the area. The data should also be seen in the context of the overall African M&A activity for 2012 which gives an indication on the large

and increasing appetite for corporate and other investors on the continent. As reported,[4] African M&A activity amounted to $32.7 billion in 2012 for 183 deals, up 4.1% in deal value. Fourth quarter deals of $15.9 billion, represent the largest quarter since 2010. Foreign investment into Africa accounted for 67% of total activity, which continues to show the attractiveness of the continent for outside investment.

In terms of size, 15 deals were in excess of $500 million, showing a majority (168) of the 183 deals were in the $5 million to $500 million range. The larger deals are dominated by transactions in the energy & infrastructure as well as financial services sectors which have traditionally attracted the more significant investments, although the largest reported deal was by France Telecom SA for a 63.64% stake in the Egyptian Company for Mobile Services at $3.2 billion. Increasingly the consumer driven sectors such as consumer goods, retail, telecoms, agriculture, financial services and utilities are becoming more prevalent.

Large private equity exits that caught the headlines include the trade sale by African Capital Alliance of MTN Nigeria to Shanduka, the South African BEE backed investment group, for $335 million, as well as the Actis led sale of Savcio, the industrial services company, to Alsom. However, it is the volume and frequency of exits below this size which investors would like to see more of.

Actis also carried out a strategic sale of 80% of Banque Commerciale du Rwanada to I&M Bank, Proparco and DEG as well as a strategic sale of 85% of the Accra Mall to Atterbury and the South African pension fund investor, Sanlam. The investments were originally made in 2004 and 2005 respectively, showing long hold periods of over 7 years each. The hold period for the Golden Lay sale by Aureos was 6 years and in contrast, the 69% sale of Ciel Capital by Swan Group in Mauritius in the insurance sector, was originally bought in 2010.[5]

There is reported to be increased interest from trade buyers such as corporates with large cash piles built up since the financial crisis,[6] as well as sovereign wealth funds from China, India, Brazil and the Gulf becoming more prevalent. The reality is that due to the African growth story, trade sales are increasingly more likely to large multinational companies looking to expand or major players in neighbouring countries seeking cross-border expansion to take advantage of the liberalised flow of goods and services within regional trade blocs.[7]

In terms of IPO activity, apart from South Africa where the Johannesburg Stock Exchange is the most developed, other African exchanges lack the liquidly and profile that investors typically desire. In fact, as many as 95% of African exits are typically via M&A.[8] However, the most striking deal of 2012 was the listing by Actis of its Uganda based national utility distribution business, Umeme. The listing was initially on the Uganda Securities Exchange (the 15th company to list there) and was followed by a listing on the Nairobi Stock Exchange, which was reported as 37% oversubscribed and a ground-breaking success, with allocation spread widely between international and local investors, local institutions and directors and staff.[9] Actis sold shares worth $37 million whilst retaining a 62% equity stake in the business.[10]

There are also now reports of the listing of Tullow Oil PLC, the FTSE 100 UK listed oil firm operating in Uganda, on the Ugandan exchange. In fact East Africa could be seen as a trailblazer for IPOs given a number of successes of late including TransCentury and CFC Insurance in Nairobi as well as Kenya's British American Investments Company, Rwanda's brewer Bralirwa and Bank of Kigali. Precision Air of Tanzania also raised funds for expansion on the Dar es Salaam Securities Exchange. East African Breweries also sold a 20% stake in Tanzania Breweries on the exchange.[11]

The Nigerian Stock Exchange, notwithstanding certain liquidity issues, and the exchanges of North Africa, as well as the international exchanges in the US, Europe, the Middle East and Asia, are also viable alternatives. The increase of dual listings has also become notable, with African companies looking to retain a national profile while also accessing international markets, usually with a GDR programme.

Documenting for an Exit

A private equity manager once eloquently described the investment process with an eye on exits as "marrying for divorce" exemplifying that it is important for the private equity investor and management to agree on the strategy and growth of the business with the exit firmly in mind. Apart from the usual investor consents and controls over the business that should be agreed up front, control over the appointment of the executive management and the finance director will be key given their importance in executing the strategy and bringing about the desired exit. Consequently, the mechanics for the exit, as well as investor and management protections discussed below, should be effectively documented upfront.

Exit clauses

It is common to include a general exit clause in the investment agreement or shareholders' agreement. However, due to uncertainty about a possible future event, exit clauses are unlikely to be legally enforceable but focus the minds of the parties and carry moral weighting. Investors typically negotiate that they will not be providing business warranties on the exit which instead should be given by management who are closer to the business. They will of course give the

typical title and capacity warranties for the shares they are selling as a minimum.

If the most desirable exit is an IPO, it would be common to legislate for this requiring the parties to approve the appointment of an investment bank by the investor, vote in favour of the process, including any reorganisation. Mechanics are also included to allocate share preferences for the sale of shares on an IPO.

In transactions where there is a syndicate of investors, or a large number of shareholders, there may be provisions for the creation of an exit committee which will formulate exit strategy, timing, structure and terms of the exit.

Restrictions on transfers

Mangers who hold equity which they were awarded at a discount (sweet equity) as an incentive to meet or exceed the business plan and exit strategy are typically restricted on transferring their shares without investor consent prior to the exit in the company's articles, save for permitted transfers such as to family members or trusts or other entities within their control or a permitted pre-emption procedure. Careful documentation of this aspect is required to ensure that the mangers remain incentivised and do not obtain an early exit.

Leaver provisions

Documenting what happens to a manager's shares if he leaves is another important area to agree and draft in to the documents up front. The investor position is typically that if a manager leaves for whatever reason he will be restricted from a free sale and required to sell his shares to the investor or the company or as directed to another party (such as a new manager or it will be warehoused until a new manger is appointed) in a prescribed manner at a prescribed price. Managers who may have rolled their equity into a new structure having been involved in the growth of the business for some time typically argue that at least their original portion should not be restricted from a sale at market value but investors typically resist this. Managers typically agree to these provisions, especially if their shares were awarded as sweet equity, although agreeing the interlinked price and leaver provisions are most hotly negotiated.

The investment documentation typically differentiates between a "good leaver" and a "bad leaver" and investors favour classifying a bad leaver as those who leave their employment for any reason other than death or disability (wide as possible). This is meant to allow a poor performing manager to be removed ("for cause") with the sale of his shares at the lower of issue price and market value. However, this would include leaving by way of redundancy or constructive dismissal, which may not be the "fault" of the manager ("not for cause"), and unfairly penalise him on the sale of his shares. A manager typically requires that he will be a good leaver if he is wrongfully or unfairly dismissed. If accepted, the investor should note that such forms of dismissal may favour the employee and entitle the manager to a sale of his shares at market value (even if in the investors view, the removal of the manager is "for cause").

Market value may be determined by an auditor or independent expert if the leaver has disputed the price offered, with the leaver not expected to bear these costs (unless the price offered for the shares and disputed is subsequently proved to be broadly accurate). Market value is generally calculated by valuing the company as a whole and applying the percentage of the fully diluted issued share capital represented by the leaver shares (that is, taking no account of the leaver's minority interest).

Drag rights

These rights are typically required by the investor in the articles to ensure the

sale of the entire issued share capital of the company on an exit, allowing for the premium on price which the investor desires. The premium is justified for the control acquired and for avoiding the need to deal with the minority or using protracted "sweep up" rights if available. It will also allow the investor to force the sale even if management believe that a better valuation could be obtained later. However, investors are less likely to favour forcing management to sell against their will as they are a critical part of the sale process and needed to give the warranties a buyer will require. Therefore, a consensual route is preferred, with the drag right used as leverage if required. A drag right would typically only be used for the odd dissenting manager or minority shareholder.

To protect management, it could be documented that at least one member of the team approve the exit but investors typically reject this in favour of certainty of forcing the deal through if needed. Management may request matching rights which is also typically rejected due to it being a deterrent to a buyer who would also like certainty in the process before committing time and expense to the transaction.

Tag rights

If a drag right is negotiated in favour of the investor the minority shareholders typically request a tag right in the articles so that if the majority sells then they can sell. Further, if the investor only sells a portion of its shares, the minority will be entitled to sell an equal proportion of their shares with the tag right. This is generally accepted, except that investors favour the tag operating as a right of the minority to offer their shares to the buyer (who may or may not accept), while managers favour the tag obliging the majority to procure the sale of the minority's shares in the sale process.

Liquidation and sale preference clauses

The articles of the company (but sometimes, for confidentiality reasons, within the investment agreement) will frequently contain liquidation and sale preference clauses under which the private equity investor is given a right to a priority return from the proceeds of the liquidation or sale of the company. In many cases, these provisions extend only to a return equal to the original investment in order to ensure they receive their investment back first before then participating with other shareholders in the remaining proceeds of any such transaction but these provisions may also be used to secure a "preferred return" (sometimes a multiple of their investment) before the proceeds of any such transaction are distributed amongst the shareholders generally.

Private equity investors usually negotiate similar clauses to achieve a preferred return on an IPO, normally by means of a re-allocation of the company's share capital through the use of conversion rights with dilutive effect, selective bonus issues or by enabling the private equity investor to subscribe at nominal value for new shares. The effect of all these techniques is to deliver to the private equity investor an increased share of the company's share capital and as a result, a higher valuation at exit via the IPO.

Conclusion

With the potential development of a secondary buyout market with new global entrants now operating in Africa together with the larger historical funds, as well as the development of viable and liquid exchanges in key regions in Africa (and the availability of the US, European and Asian exchanges) and increase in interest from large trade buyers there should be no shortage of exit opportunities for businesses at the right value and time in their lifecycle offering future investors with sufficient potential for value growth.

Notwithstanding the above contractual position typically negotiated into the investment documentation (which will provide leverage at the time of an exit), an investor's stance on the exit should continue to be flexible as market conditions may change.

Without doubt, as we have seen through a number of the transactions that we advise on in the sector, it is key to structure and document the exit from the outset, but it is also critical to work collaboratively with management throughout the life of the investment, to prepare for and achieve the desired outcome on exit.

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[1] V Shankar, Standard Chartered's Head of EMEA quoted in "Africa to be next boomtown for private equity" Reuters, 20 April 2012

[2] Novogratz and Kennedy (2010), 'Innovation for the Bop: the Patient Capital Perspective'

[3] Private Equity Africa Africa's PE exits hit record high, 11 January 2013

[4] Mergermarket African M&A Roundup 2012 www.mergermarket.com

[5] EMPEA "Views from the Field: Taking Stock of 2012", December 2012

[6] Ernst & Young "Private Equity Roundup - Africa" February 2012

[7] Bill Hinchberger "Africa: Private equity versus

[8] Ernst & Young "Private Equity Roundup - Africa" February 2012

[9] Power distributor Umeme to sell 38.3% stake in IPO on Uganda bourse" Emerging Markets Direct, 15 October 2012

[10] EMPEA Review, Volume VIII, Issue 4, December 2012

[11] Peter Mwangi "East Africa: Umeme Set for Dual Listing in Kenya, Uganda" The East African, 5 February 2012

A comparative analysis of Reserve Based Lending in Cameroon, Ghana, Nigeria and Uganda versus the UK - Structural Considerations and Challenges

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Background

Reserve based lending (RBL) is a specialist method of leveraged financing that involves lending on a non-recourse basis against one or a portfolio of upstream (undeveloped or producing) oil and gas (O&G) assets where the amount of the available facility is adjusted according to the underlying value of those assets. Specialist reservoir engineers contracted by the lender will produce detailed forecasts based on the estimated value of the available reserves and a number of other economic and financial factors. Using these forecasts, the lender will calculate the expected net present value (NPV) of the future production from the fields in question, or borrowing base. The borrowing base will be re-determined periodically to account for the fluctuation in value of the asset portfolio. The level of committed facility that the lender makes available to the borrower will be adjusted in line with the borrowing base. As reserves reduce over time, the available revolving facility will amortise in accordance with the projected production of the relevant asset(s).

Over recent decades, the traditional US and North Sea models of reserve based lending have been adapted and rolled out across different upstream markets. Market standards between, for example, the North Sea and a number of major jurisdictions in sub-Saharan Africa vary considerably in terms of acceptable asset categories, gearing, lending structures and security packages. The degree of variation is a factor of the history of the market (i.e. which lenders opened up the market and consequently which traditional model was adopted), the liquidity of that market (for purposes of syndication) and the extent of development of a legal (and in particular security) framework within that market (which is largely dependent on market maturity). As discussed below, the international O&G market is undergoing a fundamental structural shift in composition from one dominated by larger international oil companies (IOCs) to one split between IOCs, highly geared independents, state-owned enterprises and small indigenous players. This in turn is impacting upon RBL structures.

This article examines the existing legal (and in particular security) structures within each of Cameroon, Ghana, Nigeria and Uganda (the "Relevant Jurisdictions") which lenders in upstream RBL transactions must navigate. The specific grounds for comparison comprise:

(i) nature of licensing regime,

(ii) availability and enforcement of security (including assignment, share charges and account control), and

(iii) enforceability of English law judgments (given that international lenders in these jurisdictions often require documentation to be governed by English law) and arbitral awards.

Where useful, comparisons are drawn against the more mature UK legal regime as it applies to RBL transactions in the North Sea. Finally, market developments in the Relevant Jurisdictions are examined.

Evolving market profile

The North Sea was for many years dominated by large IOCs, which employed RBL as a means of obtaining unsecured loans to production subsidiaries. Lenders took comfort

from the provision by parent sponsors of investment-grade pre-completion guarantees, which would fall away once production had begun.

With the evolution of the North Sea market over recent decades, project loans have been made available to ever smaller sponsors. In particular, highly geared, independent exploration companies acquiring non-core asset portfolios, often with a much larger development component, have presented a problem to lenders. This evolution has followed in the Relevant Jurisdictions. In Nigeria for example, continuing divestments of O&G assets by Nigerian National Petroleum Corporation's joint venture partners (i.e. IOCs) have led to the emergence of a growing number of foreign-owned independents and indigenous operators as key players in the sector (see discussion of Afren PLC and Tullow Oil PLC below). Most of these developments have been driven mainly by IOCs' bid to evade the maturing onshore liabilities and the envisaged unfavourable profit-sharing arrangements in Nigeria's draft Petroleum Industry Bill.

Nature of licensing regime

A key legal consideration for any RBL lender seeking to take security will be the licensing regime under which the borrowing base assets are located. The regimes of the UK and the Relevant Jurisdictions share certain characteristics. In contrast to the US regime, under which lenders are able to take a legal mortgage over the physical reserves in the ground, in the UK and the Relevant Jurisdictions, lenders cannot take direct security over reserves and instead must look to take security over the borrower's contractual rights under the O&G licence issued by the host government, any Joint Operating Agreement between the O&G operating partners, and in the case of the Relevant Jurisdictions, a Production Sharing Agreement (PSA) between the O&G partners and typically a state-owned enterprise. In Cameroon, O&G activities can be carried out through either a concession or a PSA. Where a concession contract is executed, an exploration permit is granted by way of decree of the President of Cameroon, whereas once a PSA is executed, the relevant permit is deemed to have been automatically granted. Due however to the requirements for Ministerial consent discussed below, security over even these contractual interests may not be available.

Also, in common with the UK, African governments typically play a principal role in the allocation and oversight of O&G exploration and production licences. Even more so than in the UK (and as evidenced by the indigenisation reforms discussed below) O&G production revenues in the Relevant Jurisdictions are of fundamental importance in generating both tax revenues and economic growth. As discussed below, this involvement has implications in terms of obtaining security.

Generally in the Relevant Jurisdictions, as in the UK, any company seeking to engage in the exploration and production of O&G reserves is required to submit a licence application to the energy ministry of that jurisdiction for an activity-specific licence. The Ministry will have full discretion in allocating the licence, however, in some cases may call upon the expertise of state-owned O&G enterprises when formulating its decision. In Ghana for example, the Energy Minister currently refers all licence applications to the Ghana National Petroleum Corporation (GNPC), as its technical advisor, for evaluation, whilst in Cameroon the government may be represented by the National Hydrocarbons Company.

However, as O&G regulation in the Relevant Jurisdictions evolves, there is a move to establish specialist regulatory bodies with oversight, under delegated authority, over the administration, evaluation, recommendation and negotiation of O&G licences. For example, the newly established Ghanaian Petroleum Commission is gradually adopting GNPC's licensing functions. This separation of responsibilities should entail a fairer, more transparent and more effective licensing system.

In all the Relevant Jurisdictions, licence applicants are required to enter into a PSA with the government, however some jurisdictions are further advanced than others in respect of standard documentation. For example, in Ghana, the GNPC, in compliance with the Petroleum Law, has developed the Model Petroleum Agreement (MPA) to serve as the basis of negotiations with licensees. One of the basic requirements under the MPA is that a contractor must incorporate a company in Ghana. This entity must be the signatory to the MPA and must maintain an office in Ghana. Following conclusion of negotiations, the draft agreement is typically sent to the cabinet for approval, executed by the parties and sent to parliament for ratification. In this regard the Ghanaian licence system is relatively advanced in that the MPA approach resembles that of the UK's Model Clauses (the standard terms and conditions attaching to each UK petroleum production licence).[1]

A feature of the UK licensing regime yet to be adopted in the less mature markets of the Relevant Jurisdictions is that of decommissioning cost management (the purpose of which is to reduce costs to the taxpayer in the event of a failed or insolvent project). Decommissioning has become an even more important issue recently in the context of maturing O&G assets in the North Sea. Under the Petroleum Act 1998 (as modified by the Energy Act 1998), the UK Secretary of State for Trade & Industry (SOSTI) can require an O&G licence applicant to provide evidence of its ability to fund its future decommissioning obligations. To aid its assessment, SOSTI can require the applicant to deliver detailed financial

information, ranging from management accounts to decommissioning cost estimates and future revenue predictions.

If SOSTI determines that an applicant may be unable to meet its obligations, it can require the applicant to provide financial security to cover its potential obligations. Security may comprise decommissioning guarantee insurance, a sinking fund or a letter of credit from the applicant's lenders, although the latter is generally favoured. SOSTI can also require funds to be ring-fenced from lenders in the event of an applicant's insolvency, to cover unmet decommissioning costs.

Security options

Assignment of licence interest/PSA

A key area of concern for RBL lenders in the Relevant Jurisdictions is the ability of a licensee to assign its licence in the event of a lender enforcing its security. Generally, a licensee will be prohibited from assigning all or part of its interest without first obtaining Ministerial consent. Likewise, a PSA (or the applicable petroleum regulations which override it) will restrict the transfer of shares in the local investment entity, if the effect would be to transfer even a minority interest to a third party. Aside from that, assignment may also be conditional on the consent of other parties to the JOA.

An outright prohibition on assignment without Ministerial consent is also the position in the UK, however since 2004 the process for creating a security interest over a licence has been streamlined and potentially made more favourable to lenders under the Open Permission (discussed further below).[2]

In granting consent, the respective Minister generally has to be satisfied that the assignee is of good reputation and has the requisite financial and technical capacity to fulfil the assignors' obligations under the PSA, all requisite agreements between the assignee and third parties will continue in force post-assignment and all assignment fees have been paid.

Helpfully for lenders, the Cameroon Petroleum Code and Petroleum Regulations set out similar pre-defined criteria against which (still subject to discretion) the Hydrocarbons Minister must determine an application for consent within 60 days of notification. In Nigeria, however, the requirements for ministerial consent can extend beyond this, with the Nigerian 2004 Petroleum Act making consent conditional on the proposed assignee being in all respects acceptable to the Nigerian government. Indeed, as witnessed in the recent unreported case of Moni Pulo Limited v Brass Exploration Limited, in which the assignment was rendered inchoate under Nigerian law, failure to obtain Ministerial consent to an assignment may potentially prove fatal. Energy ministries may in some instances provide a letter of comfort to allow assignment by way of security. Failing that however, due to the bureaucratic and other challenges associated with obtaining ministerial consent, RBL lenders in the Relevant Jurisdictions may consider the assignment security option an unattractive proposition and instead look to other forms of security.

Under the more streamlined Open Permission in the UK, the SOSTI consents to the creation of security over any interest in a production licence (including an assignment right) on the condition that the licensee delivers notification (with the requisite details) within 10 days of the creation of security. The Open Permission expressly does not constitute consent to the exercise of any rights to sell or transfer any interest in a licence to a third party. However, given that a UK petroleum licence regulates the position between SOSTI and the licensee, in the absence of notice, technically a chargee (i.e. lender) can opt to enforce its security and appoint a receiver or administrator. An administrator or receiver could not sell a licence interest without consent, but it is possible that they would not require Ministerial consent to take over and run a borrower's interest under a licence. Ultimately however, there remains a risk that SOSTI could revoke a licence on appointment of an administrator.

Share charge

Given the reluctance of lenders to take an assignment over the borrower's interest in a licence and/or PSA, a charge over the shares of the borrower entity that holds an interest in the licence and/or PSA appears to be the security option of choice in the Relevant Jurisdictions. Under this, the borrower's shareholders pledge their shares to the security trustee and this enables the lenders to effectively take over the borrower company in an event of default.

In respect of Nigeria, it is arguable whether the decision in the *Moni Pulo* case can reasonably be stretched to impose a requirement for Ministerial consent in relation to creation of a share charge, although it was held that any change in control of the licence holder could be interpreted as an assignment of the licence interest itself. Even if a share charge over the licence-holding entity can validly be created, the risk remains (as in Ghana) that Ministerial consent is still required to perfect that security.

Assignment of key contracts

Assignment of key contracts is generally an accepted feature of any security package, both in the Relevant Jurisdictions and in the UK, and may include an assignment of the borrower's rights (including any receivables due) under crude petroleum handling, hedging and off-take agreements. It should be noted however that in some

jurisdictions, notably Ghana, assignment of key contracts may only be permitted to the extent that it does not contravene the requirement for Ministerial consent in relation to rights and obligations under the PSA. In all cases, lenders will seek to perfect their security by giving notice of the assignment to the borrower's counterparties under those contracts.

Security over bank accounts

Given the aforementioned problems around securing assignments and charges over O&G assets, it is crucial that lenders exert sufficient control over cash flows arising from the borrowing base. In both the UK and the Relevant Jurisdictions, this is best achieved through the adoption of fixed and floating charges over the borrower's bank accounts and importantly, this does not require Ministerial consent.

In Cameroon for example, the OHADA New Uniform Act has created a specific regime for pledges over bank accounts.[3] The OHADA Act requires that the pledge instrument must be evidenced in writing and perfected by filing it with the company registry of the place of incorporation of the borrower. Where the borrower is not a party to the pledge instrument, the pledge must be notified to the borrower in order for it to become enforceable. The arrangements for the uses of sums held in a charged bank account are for the parties to determine mutually.

In addition, the OHADA Act creates new types of security interests and institutes a legal regime for the taking of security by a security trustee - an important development towards syndicated lending. The significance of the OHADA Act, and its predecessor acts, lies in the objective to promote a harmonious and open legal and business environment throughout the OHADA jurisdictions.[4]

Lenders in the Relevant Jurisdictions should be aware of restrictions imposed by host governments on the export of O&G revenues (see discussion of indigenisation reforms below). Under Nigerian law, for example, all O&G companies must maintain a domestic bank account in which a minimum of ten per cent of their total revenue accruing from Nigerian O&G operations must be retained.[5] Such restrictions limit the effectiveness of revenue streams as a defensive security option. To strengthen their security, lenders may resist revenue account domiciliation (where possible) by requiring that O&G revenue bank accounts be sited in offshore jurisdictions or the UK, where it is generally easier for lenders to enforce their security.

Security limitations and mitigating options

In light of the above limitations, a security package in an RBL transaction, particularly in the Relevant Jurisdictions, is widely considered a shield rather than a sword. The nature of RBL means that a lender should be able to adequately limit its exposure through the operation of the borrowing base itself. To seek greater security however, lenders may also deploy innovative methods to limit their exposure to reserve risk. Where borrowing bases consist of assets held by multiple entities within a corporate group, lenders may, for example, require each asset-owning entity to cross-guarantee the debts of each other entity and the liabilities to be secured by each of their assets.

Lenders should be aware however that local restrictions may be imposed on these cross-guarantees, as well as on exchange controls and the category of liability permitted. Lenders can also seek protections in the RBL finance documents, for example through covenants that the O&G assets are developed and operated in accordance with the applicable law and that certain financial ratios are maintained.

Managing Foreign Exchange Risk

In order to protect the value of debt repayments, lenders will want to minimise risks arising from adverse movement in currency exchange rates. Although the ideal position would be for all cash flows (including contractor, off-taker, facility drawdowns and repayments) to be denominated in the same currency, in reality a mismatch often arises. The best way to deal with this, apart from convincing the relevant parties to accept payment in the favoured denomination, is to enter into foreign exchange hedging arrangements, typically with one or more of the principal lenders. While hedging itself presents challenges, failure to mitigate foreign exchange risk may render an O&G project unbankable.

Enforceability of English law judgments and arbitral awards

In instances where aspects of an RBL transaction are governed by English law or where agreements contain arbitration provisions, lenders will want to ensure that any English law judgments or arbitral awards in relation to disputes arising from the RBL finance documents are enforceable in the jurisdiction in which the O&G assets are located. Subject to certain exceptions and conditions, the courts of each of the Relevant Jurisdictions will recognise English law judgments as enforceable, pursuant to their respective reciprocal enforcement treaties with the UK (as transposed into national law).

Any final and conclusive judgment obtained in England will as a result be enforceable without examination of the merits of the case, following registration in the court of the respective jurisdiction (or in Cameroon following an application to the court for an order of exequatur (a legal document issued by a sovereign authority allowing a right to be enforced in the authority's domain of competence).

Time limits vary, however in Ghana for example, a lender has 6 years from the original judgment to seek reciprocal enforcement. Arbitral awards are also enforceable in each of the Relevant Jurisdictions, since each is signatory to the 1958 New York Convention.[6]

General market developments

As discussed above, a major market development both in the UK and in the Relevant Jurisdictions is the rise of the independents and use of RBL to finance their growing portfolios. The most notable recent transaction supporting this trend was the US$3.5 billion refinancing of Tullow Oil PLC 's RBL-financed Ghanaian O&G assets (including the giant Jubilee field) in November 2012. The new seven-year deal was backed by the IFC and 26 commercial banks, led by BNP Paribas, Crédit Agricole, HSBC, Lloyds and Standard Chartered.

Another notable market development is the increasing indigenisation of African O&G revenues and the resultant partnership of western independents with indigenous partners. On-going reforms, from Nigeria's draft Petroleum Industry Bill and the Nigerian Oil and Gas Industry Content Act 2010 to Ghana's Petroleum Commission are, at the expense of IOCs, seeking to achieve greater indigenous participation in the O&G sector and companies such as Afren PLC are well positioned to take advantage. A London Stock Exchange FTSE250 listed company, Afren PLC lays claim to be the leading independent partnering with indigenous capacity in Africa.[7] Whilst largely relying on access to the international capital markets, it also sources African capital, evidenced for example by the participation of Nigerian banks in the RBL syndicates which in March 2010 secured US$450 million against the Eboke offshore oil field reserves (with BNP Paribas, Crédit Agricole and Natixis as lead mandaters). This model has the potential to be replicated in the less mature markets of East Africa.

As demonstrated by these transactions, RBL continues to prove an attractive funding method to both lenders and borrowers alike, especially independents and marginal field operators. In light of the evolving legal structures, continued IOC divestments (brought on, for example, by Nigeria's draft Petroleum Industry Bill) and increased activity of independents such as Tullow Oil PLC and Afren PLC, the horizon for RBL transactions in the Relevant Jurisdictions appears to be a promising one.

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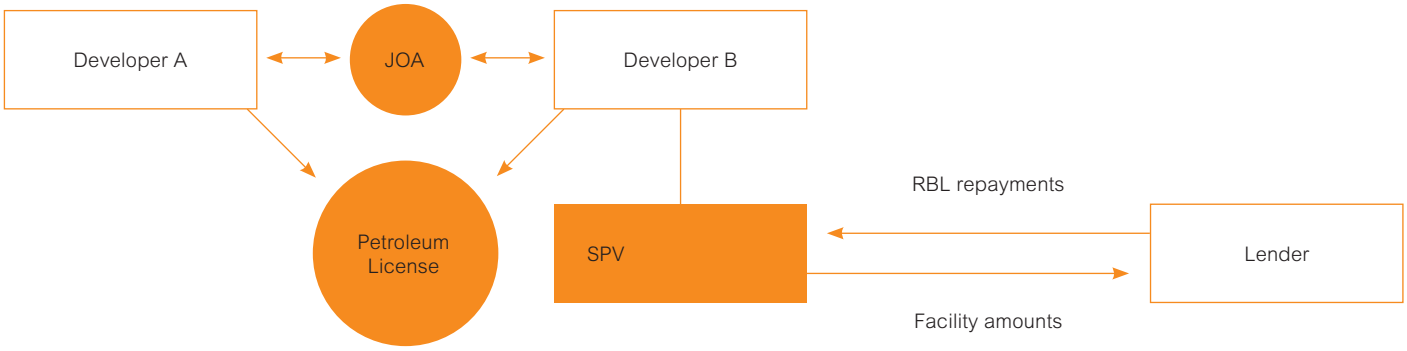
A typical RBL lending structure



1 See the Petroleum Licensing (Exploration and Production) (Seaward and Landward Areas) Regulations 2004 for the Model Clauses that will currently be incorporated into (new) UK licences.

2 See open permission (*Creation of Security Rights over Licences*) issued by the Department of Trade and Industry on 19 March 2004.

3 The Organization for the Harmonization of Business Law in Africa adopted a new uniform act on security on 15 December 2010 (the "OHADA Act"). The OHADA Act entered into effect automatically in each member state, without any further formalities, on 16 May 2011 and governs all security created on or after that date.

4 The OHADA member states generally comprise those jurisdictions in Africa with a Francophone legal system and do not currently include Ghana or Nigeria.

5 See Section 52 of the Nigerian Oil and Gas Industry Content and Development Act.

6 The 1958 New York Convention for the recognition and enforcement of foreign arbitral awards.

7 See 'Oil & Gas Afren - a unique African approach' http://africanresourceinvestor.blogspot.co.uk/2012/11/oil-gas-afren-unique-african-approach.html

Q&A with Dr Gachao Kiuna, CEO of TransCentury Limited

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Tell us about TransCentury (TC)

TC is a Kenyan headquartered infrastructure company, with a track record for delivering unique investment opportunities and executing for success. TC's key focus areas are the Power Infrastructure, Transport Infrastructure, and Engineering sectors. The Group is geographically diversified, with a presence in twelve countries across East, Central and Southern Africa and is listed on the Nairobi Stock Exchange (NSE), where it trades under the symbol 'TCL'.

What is your background?

I previously worked for McKinsey advising corporate clients in emerging markets on corporate finance, strategy, operational excellence and organisational effectiveness. While at McKinsey, I also focussed on economic development (e.g. country strategy) and electric power (particularly power generation) and was the principal consultant that led the McKinsey assignment to develop the Vision 2030 project for the Government of Kenya.

I have a BSc in Biochemistry from Imperial College, and PhD from the University of Cambridge, Corpus Christi College.

If you could pick one, what would rank as the most exciting deal you have been involved in while at TransCentury?

One of the many exciting deals would be our investment in Civicon Limited. Civicon is the premier civil and mechanical engineering company in East Africa and boosts over 40 years of engineering pedigree in the region. It is the pre-eminent oil and gas contractor and power generation contractor. In addition the company deals in specialised transportation, which is very strategic for

its business. Civicon is currently operating in the Democratic Republic of Congo; Djibouti; Kenya; Rwanda; South Sudan; Tanzania; and Uganda. The timing of this investment also occurred right before the exciting oil and gas discoveries in the region, making Civicon well placed in continuing to lead the market in this area.

What is the main challenge you are faced with in doing business in Africa?

The main challenge is the access to capital to fund infrastructure projects. Both debt and equity capital needed to execute projects is limited. Currently we are noticing some Development Finance Institutions getting involved because they recognise this gap. However, this is insufficient and there needs to be a transformation of domestic and foreign private capital coming into the market to close the gap, and promote investment in infrastructure development, which is both lucrative and strategic.

What are the current trends/investment opportunities in Kenya?

Kenya's population has experienced exponential growth since her independence in the 1960s to date. The population in the 1960s was c.7million and is now c.40million and counting. It follows that the size of the domestic economy is significantly larger than what some may appreciate. To put this in context, I grew up in Nakuru, a little rural farming town nestled in the Rift Valley with a population of 60,000 people then. Today Nakuru is one of the important urban centres in the country with a population of well over 1,000,000 people. This staggering population growth has created huge demand for infrastructure investment in housing; electricity; roads; water; etc. This demand in turn represents a tremendous opportunity for those willing to invest.

If TransCentury was to be granted one wish for the future, what would they be?

To be the preferred company in which investors would want to invest in and where top talent would want to be employed.

What would you say are three main differences between working in Africa vs. Europe/USA?

First, growth - the opportunity for growth is tremendous. For example TC has been doubling in size each year, an achievement which would be difficult in developed markets. Second, transformation - as I mentioned, we've transformed from a chama (savings investment club) to an investment company, to a fully-fledged infrastructure company within a very short space of time. Third, opportunity - I'm 35 years old. In fact, the average age of our team here at TC is just below 35. This opportunity exists across the board in Africa, as seen most recently in the appointment of Joshua Oigara, 38 as the CEO of Kenya Commercial Bank, arguably the largest commercial bank in East and Central Africa.

What is the best thing about your job?

I can directly see the impact of what we do. For example, in our power business, we have helped to give access to electricity to over 2 million households (from 500,0000 households). This represents 4 times more households having access to power within a period of less than 10 years. Through Civicon, we have built and rehabilitated over 6,000 kilometres of road in South Sudan and the DRC to open up access for investment in the Mining and Oil and Gas sectors for our clients. Our ethos is all around "investing in Africa" and "transforming lives" and the impact is visible.

What African businessperson do you most admire and why?

Aliko Dangote. I have personally worked with him, and despite the huge amount of success in business he has had he maintains his humility. He is focussed on fundamentals, achieving basic needs for the African consumer. He has made a huge impact in business – impacting not only the livelihood of the people of Nigeria, but Africa as a whole.

What is the most interesting African country you have visited (for work, pleasure or both) and why?

The Democratic Republic of Congo. From a work perspective, the high level of work ethic of the people is second to none. This is surprising for a country with such a poor image amongst the international community. From a leisure point of view, Kinshasa is a very vibrant, energetic city with a population of around 10 million people. Despite the challenges of poverty, it is a safe city. The openness of the people, the electric music, the warm ambience, and of course – the amazing restaurants makes it the most interesting African country I've visited.

Share one of your favourite things with us?

Playing with my daughters.

If you could have any super power what would it be?

The power to turn back time. Most of Africa shares a common story of missed opportunity despite its huge potential to be as or more successful as the BRIC and Asian economies. To put this in context, Kenya in the 1960s was in the same place as Malaysia and Singapore.

What do you do to relax?

Play golf. How often I get the chance to relax is another issue.

Investing in Nigeria: an overview

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There are numerous reasons why Nigeria, a member of the "N-11",[1] is increasingly viewed as a viable and attractive investment destination. Like the other countries that make up the N-11, Nigeria's "attractive demographics, rising income and increased domestic consumption…"[2] could make it a significant contributor, along with the other N-11 countries, to global growth in the next decade. Foreign direct investment ("FDI") increased to $8.9 billion in 2011 (in 2010 this figure was only $2 billion,[3] primary due to the Arab Spring).

Nigeria is viewed as having a positive economic outlook with the largest population on the continent (at 160 million people), various natural resources, and a need for infrastructure. In addition, a slowing European economic market has caused investors to consider Nigeria for a better return on investment.

In line with Nigeria's drive to increase FDI, the legal and regulatory framework is favourable in a variety of sectors, to attract foreign investors. Examples of which are explored further in this article.

The Nigerian Investment Promotion Commission ("NIPC") and Strategic Initiatives

The NIPC

The NIPC was established to promote, co-ordinate and supervise all investments in Nigeria[4] and has various functions including; co-ordinating and monitoring the creation and operation of businesses; introducing measures to promote investment in Nigeria; collating and providing information on investment opportunities in Nigeria; keeping record of businesses subject to the Nigerian Investment Promotion Commission Act No.16 of 1995 (the "NIPC Act"); promotional activities and advising the Nigerian federal government on policy matters.

The NIPC is made up of various departments that facilitate its primary objectives. There is a department that focuses on direct marketing, with the aim of promoting Nigeria and highlighting investment opportunities (the NIPC has promoted investment in Nigeria by hosting business investment forums globally). The department of investor relations provides pre-investment and after-care services and keeps a record of FDI in Nigeria. There is also a department dedicated to campaigning for the improvement of the Nigerian investment climate by proposing policy changes.

OSIC

The NIPC also has a One Stop Investment Centre ("OSIC") that allows investors to perform all the necessary administrative functions needed for setting up and investing in businesses in Nigeria. Investors can go to OSIC to obtain licences, permits and for incorporation purposes. OSIC ultimately aims to streamline procedures and reduce the cost of doing business in Nigeria.[5] OSIC also aims to maintain transparency in Nigerian business administrative services and provides investment information to prospective investors. The centre also has the aim of upholding the professional working relationship between government agencies and ministries to further support investors in their dealings with business administration.

Vision 20:2020

Vision 20:2020 was instigated by the previous Nigerian government to make Nigeria one of the top 20 economies in the world by the year 2020. The current administration led by Goodluck Jonathan has committed to continuing to achieve the aims of Vision 20:2020. The Government published a transformation agenda for 2011-2015, which builds on the aims of Vision 20:2020 and the 1st National Implementation Plan (which set how the first phase of Vision 20:2020 would be achieved)[6] (the "Agenda"). The Agenda notes that despite growth, there has been a lack of "continuity, consistency and commitment in the policies, programmes and projects" that exist to improve Nigeria's economy, the Agenda aims to harmonise previous efforts. The Agenda assumes that GDP growth will average 11.7 per cent (in comparison to GDP growth of 8 per cent for the period of 1999 – 2010) in line with the Vision 20:2020 target and outlines the changes to policies needed and new programmes that the government will instigate to achieve the target. The government aims to review its monetary and fiscal policy, review governance practices, instigate infrastructure projects and concentrate on "enablers" including "private investment, finance mobilisation and external economic relations and diplomacy".

Since the NIPC and OSIC were established investment into the Nigerian economy has steadily increased, especially in non-oil industries. It is clear that the current government is keen to encourage investment to strengthen the economy and achieve ambitious targets.

Legislation and Regulation

Legislation

Previously, FDI in Nigeria was obstructed by minimum capital requirements and indigenous ownership thresholds (of up to 40 per cent in some cases). The NIPC Act replaced previous acts on foreign investment in Nigeria and essentially removed restrictions on foreign ownership of business in Nigeria, except for in limited circumstances. 100 per cent foreign ownership of Nigerian businesses is possible except for within the oil and gas industry, where investment is limited to existing joint ventures or new production sharing agreements and the Nigerian Local Content Act passed in 2010 seeks to promote local participation in the industry. The draft Petroleum Industry Bill will also have a significant impact on investment and foreign ownership when passed.

There are also special protected sectors viewed as important to national security, such as the production of arms where investment is prohibited for both foreign and Nigerian investors.

The NIPC Act also introduced legislation to prevent businesses from being nationalised or expropriated by the Nigerian government and protection against an investor being forced to surrender his interest in the business.[7]

There is no requirement to seek investment approval before doing business in Nigeria. Businesses must first be incorporated through the Corporate Affairs Commission ("CAC") and must then register with the NIPC to be protected by the provisions of the Nigerian investment laws. Companies that are part of Nigeria's "Export Free Zones" are not required to register with the NIPC as investment approvals are governed by the Nigerian Export Processing Zones Authority ("NEPZA"). NEPZA governs the various free trade zones across the country. Free trade zones or Export Free Zones were created for companies whose main purpose is to produce products for export to confer on those investors various incentives including exemptions from local and government taxes, imports without custom duties and rent free land during the construction period. The first Nigerian free trade zone was in Calabar with construction completed in 1999 and operations commencing in 2001. Although created to encourage FDI, free trade zones have had to deal with problems caused by poor quality access roads and inconsistent power supply.

Liberalised exchange control provisions

The Foreign Exchange (Monitoring & Miscellaneous Provision) Act no. 17 of 1995 (the "Foreign Exchange Act") liberalised the exchange control regime of Nigeria so that it is now easier to import capital and repatriate profits. The Foreign Exchange Act created an autonomous foreign exchange market for transactions with end-users through authorised dealers (such as banks). Under the provisions of the Foreign Exchange Act investments can be made in foreign currency or using imported capital, however information on transactions must be filed with the Central Bank of Nigeria (the "CBN") by an authorised dealer within 24 hours. The CBN will then issue the investor with a certificate of capital importation ("CCI").[8] The CCI ensures the unrestricted transfer of dividends and capital made from any investment.

The Foreign Exchange Act specifically makes provision for the transferability of capital in any convertible currency

without any conditions, in relation to dividends or profits (net of taxes) attributable to the investment; payments in respect of loan servicing where a foreign loan has been obtained; and the remittance of proceeds (net of all taxes) and other obligations in the event of sale or liquidation of the enterprise or any interest attributable to the investment.[9] The transfer must be made through an authorised dealer, the authorised dealer must check supporting documents such as the CCI and tax clearance certificates before making the transfer.

Trade and Bilateral Investment Agreements

The Nigerian federal government has entered into a number of Bilateral Investment Promotion and Protection Agreements ("BIPPAs") to further encourage investment in the Nigerian economy. The intention is that BIPPAs protect investments in the case of war, revolution, expropriation or nationalisation. They are also entered into to guarantee the transfer of interests, dividends, profits and other income as well as compensation for dispossession or loss.[10] Nigeria has so far entered into BIPPA's with countries including France, Netherlands, Switzerland, Romania, Spain, UK, South Africa, China and Germany.

Nigeria is also a member of the African Union and Economic Community of West African States ("ECOWAS"). The government has made efforts to promote the country as an access point for the ECOWAS region because of its location.[11] It is also a member the World Trade Organisation, the European Union Partnership Agreement and the Organisation of Petroleum Exporting Companies, each aimed at promoting investment.

Tax as an Investment Incentive

Corporation tax for non-resident companies in Nigeria is charged at 30 per cent and is only charged on Nigerian sourced income. For resident companies there is also an additional 2 per cent education tax levied. Capital gains, interest and dividends are taxed at 10 per cent for both resident and non-resident companies.[12] Companies in the oil and gas sector and construction companies that serve the oil and gas sector have separate tax regulation. There are various tax incentives in place that reduce tax liability, especially in key sectors to the Nigerian economy needing investment.

Other industry specific tax incentives include tax exemptions from interest earned on agricultural loans (where certain conditions are met) in the agriculture industry; exemptions from custom and excise duties on plant machinery in the export and mining industries; 20 per cent of the cost of providing basic infrastructure in areas where infrastructure does not already exist is tax deductible (once only); and 120 per cent, or 140 per cent, in respect of local raw materials, of expenses on research and development conducted in Nigeria is tax deductible.

Pioneer Status

Investors may be able to take advantage of the benefits of pioneer status, which affords businesses with varying tax benefits dependant on the type of industry and location. Generally, pioneer status can mean an exemption from income tax for an initial period of 3 years (with the possibility of an extension to 5 years), tax free dividends during the tax free period, losses during the tax free period being set off against profits after the end of that period and capital expenditure which would have occurred during the tax free period being deemed to have occurred on the first day after the end of the tax free period, so that capital allowances can still be claimed.[13] To benefit companies must apply to the NIPC.

Double Taxation Treaties

Nigeria has entered into double taxation treaties with the UK, France, Netherlands, Belgium, Pakistan, Canada, Czech Republic, Philippines, Romania[14] and in August 2012 Nigeria also entered into a double taxation avoidance agreement with Mauritius, a country viewed as a gateway for investment in Africa.[15] Nigeria's double taxation treaties apply a "tax credit" method, so that the total tax payable in Nigeria is reduced by the total tax to be paid in the foreign country where profits are being remitted and vice versa. The Nigerian government has also approved lower tax rates on dividend, interest, royalty and rent payments made to owners who are located in treaty countries.

Investment in Non-Oil Sectors

The Nigerian federal government identified in its Agenda seven sectors that will be the main growth sectors between 2011 and 2015, being agriculture, water resources, solid minerals, manufacturing, oil and gas, trade and commerce and culture and tourism.[16] The Agenda additionally identified the need to improve infrastructure to facilitate growth. Below is a snapshot of key sectors, identified in the Agenda.

Agriculture

As 40 per cent of Nigeria's 84 million hectares of arable land is currently untapped[17] and the country was once a leading world food producer, the Nigerian government is seeking investment and incentivising indigenous companies to take advantage of this potential. To reverse the trend of vast food imports the government has introduced measures to encourage dairy companies and millers to use local ingredients and the CBN is giving commercial bank loan guarantees to encourage lending to farmers.[18]

Other incentive specific to the agriculture related businesses include a disapplication of the 60 per cent threshold on the application of capital allowances and 30 per cent tax concession for 5 years if agriculture companies use at least 80 per cent of local materials (70 per cent for agro-allied businesses).[19]

Infrastructure

Economic development and wealth creation requires strong infrastructure, as a result, the Nigerian government has placed a premium on infrastructure projects in recent years.[20] The government reinforced this focus in its Agenda by implementing priority policies for infrastructure development covering the seven key sectors. Public Private Partnerships ("PPPs") are also being used to assist in providing this much needed infrastructure, the Nigerian government recognises that the private sector can bolster deficiencies in public services.

There are two governing bodies that oversee PPPs. The Infrastructure Concession Regulatory Commission (ICRC) was created in 2005[21] to monitor, oversee and regulate PPP projects. The ICRC also has the specific function of taking charge of all PPP concession agreement and monitoring compliance with those agreements. The Bureau of Public Procurement ("BPP") was established in 2007[22] to create a legal framework for public procurement standards in Nigeria. BPP was created to bring together existing public procurement policies, implement pricing standards and to uphold transparency and competition.

Consumer Goods

Nigeria's large population and a positive economic outlook is enticing consumer businesses to enter the market. Retailers such as Massmart (partly owned by Walmart), Artee (a Nigerian based business that has partnered with Spar) and Shoprite all announced expansion plans in 2012.[23] There is a high demand for the shopping centres and an opportunity for first mover advantage due to brand consciousness.[24] International companies are viewing Nigeria as an attractive investment destination to boost slowing national growth, because of the consumption potential of the population size. Despite obstacles such as infrastructure and local spending practices businesses are adapting to break into the market, by partnering with local enterprises or adopting a distribution model.

Economic potential and under-developed infrastructure means that there are numerous investment opportunities for FDI in Nigeria and the regulation and initiatives are further encouraging this. The private equity industry has also made tracks to invest in Nigeria.

Private Equity Investment in Nigeria

Private equity investment in Nigeria, like FDI, has sought to take advantage of the opportunities created by a growing economy, government incentives and reforms. One reform has caused an increase in investor capital as Nigerian pension funds can now invest (up to 5%

of assets) in private equity. Private equity investors are also targeting industries such as telecommunication, mining, oil and gas, food and agro-businesses and financial services that form part of the government's sector focus, this investment being representative of the needs of the emerging middle class. Private equity investment however, is not necessarily targeted at businesses that will yield a rapid return, but in investments that create a supply chain, jobs and ultimately longer term potential for sustained return to investors and an eventual exit at a significantly higher value.[25]

The regulatory reforms that have relaxed the Nigerian investment rules and exchange control provisions are also applicable to private equity investors. As stated above, the rules on the repatriation of foreign capital have also been liberalised, the CCI has made it easier for foreign owned companies to return profit to their home jurisdictions irrespective of the amount of capital initially invested. The CCI has created a quick and efficient mode of transferring profit so long as an investor is compliant with the requirements of repatriating funds, this raises compliance considerations for fund managers. An important consideration is that underlying companies are transparent in their dealings and use reputable professional advisors,[26] this is particularly important in a jurisdiction that continues to face problems with corruption.

Difficulties in the local operating environment of Nigeria, also highlights the importance of local knowledge. The development of the mobile phone industry is an example, the lack of enforcement legislation and high rate of people without fixed addresses meant that a mobile phone industry based on bills could not work. In addition, poor infrastructure for land line communication led to the rapid growth of the pre-payment mobile telecoms industry. FDI in the telecoms industry increased by 39 per cent between 2009 and 2012[27] and investment opportunities still exist as there is now a need for better services, coverage and broadband technology.

Conclusion

The demands of a burgeoning middle class and the initiatives of Nigeria's government has spurred investment opportunities in industries that extend beyond the traditional destinations of oil and gas. There are investment opportunities in consumer industries, agriculture, infrastructure and telecoms and positive economic outlook for Nigeria will further encourage investors.

The Nigerian government has recognised the benefits of foreign investment in achieving economic growth and stability, however concerns with corruption, political instability, poor infrastructure and financial misconduct has in the past deterred FDI. To counter this, tax incentives, a liberalised regulatory system and strategic initiatives are being used to encourage investment. A continued coherent strategy will help to further entice investors.

Africa is also one of the last untapped regions for private equity investment, the potential created by the growing population and rising economy in countries such as Nigeria is high if investment is deployed to support the growth business sectors of the country. The private equity model of investment, development, and diversification of risk is well suited to accelerating growth and reaping the potential of the Nigerian economy.

The author would like to thank Jide Olanrewaju of Satya Capital LLP for his contribution to this article

1 The Next 11, an acronym for the next set of countries (Bangladesh, Egypt, Indonesia, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam) with a promising outlook for growth and investment potential as named by Jim O'Neill and the Global Economics, Commodities and Strategy Research team of Goldman Sachs in 2005

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7 NIPC Act 1995, section 25

8 KPMG Nigeria fiscal guide 2012/13

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22 ICRC was established by the Infrastructure Concession Regulatory Commission (Establishment etc) Act of 2005

23 BPP was established by the Public Procurement Act of 2007

24 Nigeria: a retailer's market , 16 August 2012

25 Bill Russo in Financial Times, "Consumer Demand draws in more retailers", 28 November 2012

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27 http://www.nigerianpro.com/news/nse-trading-platform-expected-market-changer

Out of Africa: Nigerian companies increasingly look to access international markets

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As growth in the Nigerian economy approaches double digits, companies in Nigeria are seeking access to low cost and long term capital in order to fund their expansion plans. As a result, a growing number of Nigeria's most successful companies are moving to list their shares on a public market.

An initial public offering (IPO) provides many rewards for a company, most notably improving access to capital and liquidity, increasing a company's public profile and providing an acquisition currency. Despite concerted efforts by the Nigerian government to lure domestic firms onto the Nigerian Stock Exchange (NSE), the lack of liquidity and profile continue to deter likely participants. We are now witnessing some of the country's most promising companies looking to list on larger, international stock exchanges, or at least considering dual listings to maintain the NSE listing for the domestic market.

Why is this happening?

Transparency and corporate governance

The NSE, under the leadership of its former director-general, Prof. Ndi Okereke-Onyuike, was characterised as an organisation that offered very little to incentivise companies to adhere to principles of transparency and good governance. Whilst the introduction of the Nigerian Code of Corporate Governance Practices in 2003 was a welcome development, challenges still remain. Regulatory institutions in Nigeria still have a way to go in ensuring that companies ingrain sound corporate governance practices in their business operations. Until this is achieved, inadequacies in the implementation strategy of corporate governance standards will continue to deter investors from the NSE.

Issues with infrastructure

The NSE has been operating an Automated Trading System (ATS) since 27 April 1999, whereby dealers trade through a network of computers connected to a server.[1] The ATS is able to facilitate both remote trading and surveillance. Whilst this is an effective trading system, it appears to have been underutilised in recent years. Many operators within the Nigerian market still lack sufficient research functions, meaning that access to trading information can often be slow or inaccurate.

Concerns over the flow of information on the NSE seem to have been heard and the Exchange is planning to upgrade its trading system to the NASDAA QMX Group's X-Stream platform by the second quarter of 2013.[2] This new system will have the capacity to handle a wider range of instruments, and will enable accounts to be accessible from smart-phones. Crucially, the system will also enable the NSE to host other exchanges' trading platforms.

Tax

There is also a need to reduce the level of tax attributable to shares traded on the NSE. Some commentators believe that the elimination of VAT from certain transactions would make the market more competitive as it would reduce transaction costs.[3] Unlike other capital markets, Nigeria currently offers no tax incentives for companies coming to list on the exchange.[4] Other nations, for example Morocco, provide incentives to encourage companies to list on their exchanges including 50% income tax rebates for companies issuing shares for the first time.

Nigerian companies listing on international stock exchanges

A total of 104 African companies are now listed on the London Stock Exchange (LSE), with a combined market value larger than every African exchange except for Johannesburg. Dual listings have become critical for Nigerian companies that have outgrown their domestic exchange, where thin liquidity keeps large investors out. This has been recently highlighted in the case of Oando Energy Resources Limited and its listing on the Toronto Stock Exchange, along with Seplat Petroleum Development Limited and Dangote Cement Plc's proposed listings on the LSE in 2013.

Nigerian billionaire, Aliko Dangote, is aiming for a valuation of up to $40 billion (£25.72 billion) for his cement company at its proposed London listing in 2013 by way of a GDR programme for 20% of the group, several times that of top global rival Lafarge.[5] Although, even such a high profile listing is not without uncertainty with reports of the group's profits below expectations, which could impact the

valuations sought. Dangote Cement Plc is a Nigeria-based company active in the building materials industry seeking expansion capital. Dangote Cement needs access to additional resources and funds in order to sustain its pace of development. Dangote has described coming to list on the LSE as a process of globalising his business and improving corporate governance.

Dangote has taken the decision to step down as Chairman and is currently looking to appoint an independent replacement. He has also strengthened his management team with the appointment of Tim Surridge, formerly of KPMG, as its chief financial officer, whose task, in the months ahead, will be to bring all the reporting procedures up to a standard common with other FTSE 100 companies.

Requirements when listing in the UK

There are a number of legal and regulatory requirements that companies must adhere to before they can list their shares in the UK. Implementing the UK Code of Corporate Governance can sometimes be a difficult undertaking for Nigerian companies listing in the UK for the first time. In the UK, the law and regulation of corporate governance is provided by a number of different rules, regulations and recommendations, including compliance with the FSA's, the Listing Rules, Disclosure Rules and Transparency Rules and the UK Corporate Governance Code and Model Code when listing. There are also industry bodies such as the Association of British Insurers (ABI) and others that issue guidelines and monitor listed companies for compliance with these standards. To attain a Premium Listing on the LSE, a company must also satisfy additional, more onerous listing and ongoing compliance obligations. These heightened standards, aimed at providing additional investor protection and shareholder confidence, are, despite being essential means to meet rigorous investor standards, time consuming and costly.

Amongst other provisions for a listing on the LSE, a company must generally have at least three years of audited financial statements covering a period ending not more than six months before the date of the offering prospectus. A company must also generally demonstrate that at least 75 per cent of its business is supported by a historic revenue-earning record that covers at least three years. Additionally, a company must satisfy the listing authority that it and its subsidiaries have sufficient working capital available to meet the needs of the company and its subsidiaries

for at least the 12-month period from the date of the offering prospectus. A company must also appoint a sponsor for the listing process.

A Premium Listed company on the LSE faces continuing obligations including shareholder approval and notification requirements for certain significant and related party transactions. Listed companies must explain in their annual report how they have applied the main principles of the UK Corporate Governance Code and whether they have complied with all relevant provisions. If the company has not complied with one or more provisions, it is required to explain its non-compliance.

The Alternative Investment Market ("AIM") of the LSE provides a "junior market" for the securities of mature and growth stage companies. AIM has also been successfully used as a stepping stone for companies who eventually are looking to trade on the Main Board of the LSE. Companies whose shares are traded on AIM must comply with AIM Rules. To be eligible, the company must be capable of offering their shares to the public, have securities that are freely transferable, appoint a nominated adviser, have sufficient working capital to carry on business as a going concern for the foreseeable future (minimum 12 months from admission) and produce an AIM admission document which complies with the AIM Rules.

Although GDR programmes have different standards of corporate governance that apply as opposed to a Premium Listing, many of the larger issues by overseas companies will adhere to the full governance standards in practice, or will do so when moving from a GDR listing to a Premium Listing.

The high correlation between corporate governance and investor decisions means that Nigerian companies, like Dangote Cement, are keen to position themselves to take advantage of the opportunities in the global market by adhering to principles of good corporate governance.

Eurobonds and Nigerian banks - a growing trend

There has been mounting interest amongst Nigerian banks in sourcing capital from international capital markets through Eurobond issuances. These banks, which are beginning to find their feet after a long-drawn out banking sector crisis, have faced the need to amass funds to enable their businesses to grow into stronger entities and to satisfy international capital adequacy requirements.[6] A Eurobond, unlike share issues, entitles the holder to a fixed and indivisible sum being the coupon/interest whilst still retaining a tradeable value. The term 'Eurobond' is generic and is used collectively to describe a variety of internationally issued securities in a currency not similar to the issuing country. This year, two Nigerian banks successfully raised over $850m through Eurobonds on the LSE. Guaranty Trust Bank Plc (GTB) raised $500m and Access Bank Plc (Access Bank) followed suit, raising $350m.[7]

Aside from GTB's landmark achievement of being the first sub-Saharan Africa financial sector benchmark Eurobond (outside of South Africa), the issuance garnered strong investor response. It was reportedly oversubscribed and placed with over 50 accounts, with US accounts representing 37 per cent of the total allocations, UK accounts 31 per cent, Africa accounts 16 per cent, Europe accounts 13 per cent and other accounts four per cent. Access Bank's bond issuance was equally successful after issuing a five-year bond with pricing in the seven per cent range. Again, the issuance was reportedly oversubscribed by $150m, meaning it could have raised more, if it had desired.

There are several reasons why Nigerian banks are seeking to access the international capital markets. Firstly, the need to finance bankable energy and infrastructure projects continues to increase. Some of Nigeria's largest banks are set to solely finance projects ranging from oil and gas to roads and power projects. The ability to source cheaper capital is essential in order for these banks to lend at more competitive rates and achieve a greater upside.

Furthermore, as the Nigerian economy continues to grow and a thriving middle class emerges, consumer finance is proving a lucrative line of business for Nigerian banks. Several banks have opened branches in more rural areas and are competing to tap into the increasing number of customers opening current accounts.

Finally, structured solutions to overcome some of the inherent risks to the issuer, such as foreign exchange rate risks attendant to issuing foreign currency denominated debt making use of foreign exchange hedging arrangements have developed the market further. Depending on the relationship with the counterparty, the issuer may seek this product for the entire term of the issuance enabling the issuer to hedge currency risks against the coupon payments.

As the Nigerian banks tend to benchmark themselves against each other, more of Nigeria's leading banks will strive to access the Eurobond markets. Diamond Bank Plc has confirmed its plan to issue a $300m Eurobond. Additionally, First Bank of Nigeria, United Bank of Africa and Skye Bank have all reportedly received the approval of their respective shareholders to float Eurobonds in 2013.[8]

There are a number of principal requirements which must be fulfilled when listing Eurobonds on the LSE. These include a two-year trading and financial record

along with a listing document that complies with the UKLA's listing rules, and with the Exchange's Admission and Disclosure Standards. Eurobonds must also be freely transferable, with market capitalisation of the class of the debt securities of at least £200,000. A company issuing convertible Eurobonds should normally have at least a three-year trading record and must also produce a cash flow statement.

Conclusion

The appetite of global investors for securities issued by African companies continues to rise as the continent looks set for above average growth over the next few years. Nigerian companies operating within the economy along with those looking to build pan-African enterprises are set to gain from this.

The listing of Nigerian companies (or GDRs) on international stock markets such as the LSE will help to raise the profile of the market, enhance liquidity and provide Nigerian banks access to cheaper capital through Eurobonds and GDRs to lend to consumers and small and medium-sized businesses at borrower friendly rates.

The LSE is well placed to host some of Nigeria's fastest growing indigenous companies, as foreign investors have favoured London (whether the Main Board or AIM) as an exchange where greater trading transparency and efficiency exists. The regulatory framework of the LSE may have restricted most Nigerian companies in the past from accessing these markets, but as these companies are now looking to expand and need new capital, the determination to 'get it right' is more important than ever before.

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Nigeria PIB: More delays in the pipeline?

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In our Issue 9 of Emerging Markets: Africa we reported that a redraft of the controversial Petroleum Industry Bill ("PIB"), which aims to reform the oil sector in Nigeria and which has now undergone several incarnations, was imminently to be presented to the Nigerian legislature in a form ready for a second attempt at being passed into law.

The original draft PIB faltered amid confusion surrounding the various versions being used around the legislature and the political squabbling between stakeholders. As a result, Nigeria experienced a period of stagnation in investment into the oil and gas industry which increased calls for an overhaul of the system. This culminated in a committee being set up in early 2012 to propose a new draft with the aim of providing a fairer deal for the country while simultaneously appeasing the various stakeholders as to their competing interests. The new draft PIB was forwarded by President Goodluck Jonathan to the Nigerian National Assembly in July of last year, the President requesting that lawmakers give the bill an 'expeditious passage.'[1]

Competing stakeholder interests

The same competing interests and stakeholder concerns that have surrounded the draft PIB continue to hamper its progress through the legislature. One hotly contested area of the proposed reform is the rate of tax payable by oil companies on production. Under the proposed new PIB, the Nigerian government can expect to receive 73% from deep-water production, up from 61% under the previous legislation. The Petroleum Minister, Diezani Allison-Madueke has claimed that such increased rate will render Nigeria a competitive location for international investment, taking into account the rates imposed by other oil producing countries such as Angola, Indonesia and Norway. However, the IOCs argue that Nigeria's fiscal terms should be more attractive than in other jurisdictions to combat against the specific concerns over the risks of operating an oil and gas business in Nigeria – notably piracy, kidnapping, large-scale oil theft and, inevitably, corruption.[2]

The Petroleum Minister also highlights the revised PIB's shift away from investment based incentives towards production based calculation of royalty and taxes. The aim is that linking IOCs' incentives to the actual amount produced will increase efficiency, increase the amount Nigeria can obtain in revenue and taxes and provide a fairer system in which the amount paid by oil companies is not based on the location of the relevant field but on how well the operator manages such field to generate production.

Predictably, however, the IOCs disagree with the Petroleum Minister's view. They claim that the bill requires further fine-tuning in order to have any hope of attracting the reported US$108 billion Nigeria is reportedly hoping will be invested in the country between now and 2025.[3] Mutiu Sunmonu, Managing Director for Shell Nigeria, has claimed that the new PIB's fiscal terms are uncompetitive and will render deepwater offshore projects, a key growth area for Nigeria, unviable for IOCs.[4] Mark Ward, Managing Director of Exxon in Nigeria has publicly stated that there is a fundamental disconnect between the level of investment the government is forecasting and the level that IOCs themselves will be willing to invest if the current draft of the PIB becomes law. In particular he notes that the current draft PIB does not contain detailed and well thought out proposals on gas pricing, market and infrastructure and that the current draft of the PIB would as a result, represent a backwards step in the opinion of the IOCs. The new draft, he says, rather than re-invigorating investment, will only serve to further stifle the willingness of the big international investors to look to Nigeria for future production.[5]

Indeed, there have already been recent moves by some IOCs to divest certain blocks, a move which has been touted by some as an attempt to escape the unfavourable terms of the draft PIB before it is made law. Shell, Total, Conoco and Agip are among those IOCs who are said to have divested around 45% of their participations in seven oil concessions across five separate transactions.[6]

The IOCs are not, however, the only stakeholders at play. Many have spoken out against the government's perceived pandering to the IOCs. As it is hoped that the PIB will provide increased participation of the Nigerian people in the revenues from the country's substantial natural resources, an IOC-favourable draft is proving politically sensitive among the community leaders, the States and the government generally. Unfortunately Nigeria's economy is very heavily reliant on oil, accounting for two thirds of its revenue and almost all of its export earnings,[7] which allows IOCs to leverage the possibility that they will withdraw from the country.

Even if a compromise position can be found to satisfy the concerns of the IOCs and generate the much-needed increase in revenue for the country, in-fighting between the North and South of Nigeria as to the method of allocation of the revenue remains another potential stumbling block for the PIB. A committee set up by North-based governors has claimed that the current draft PIB would not only increase the proportion of the derivation from the Federation Account allocated to the oil-rich southern states, but would also see 10% of IOCs' profits go to these states without similar provision being made for the North. This, activists from the North claim, is an unacceptable enrichment of one area at a time when the country should be pooling resources for the benefit of the country as a whole.[8]

Impact on the NNPC

There are also serious concerns and uncertainty as to how the new PIB will impact on the Nigerian National Petroleum Company ("NNPC") going forward. Currently, the NNPC operates as a wholly State owned vertically integrated oil and gas company that undertakes activities upstream, downstream and midstream. It also owns and operates refineries, networks and pipelines to support supply to bulk purchasers. Its subsidiaries operate joint ventures with IOCs in upstream exploration activities and also operate their own exploration activities. The NNPC is in the process of implementing the Gas Master Plan and developing renewable energy opportunities such as bio fuels. However, it is completely reliant on the State for funding as it is required to return its entire surplus to the State and await its annual budgetary allocation. It is hoped that the revised PIB will address the NNPC's funding issues as it cannot raise its own finance without State guarantees, which have not been forthcoming.

With the proposed creation of a National Oil Company ("NOC") which it is intended will hold certain assets of the current NNPC (other than the government interests in upstream unincorporated joint ventures) and to be managed as a commercial utility, it is still not clear how autonomous it will actually be, both in terms of decision making/control and the critical area of funding. It appears that on this latter issue, the status quo will remain. As a minimum, a workable revenue retention model in line with other NOCs of approximately 70% will be needed as well as an asset base against which the NOC may borrow on the international markets.

Ministerial approval a concern

Other areas requiring clarity include the wide powers for the Minister to revoke, grant and amend upstream licences which would be unpalatable for the IOCs and investors. There are also more extensive restrictions on assignments and M&A which are wider than the current legislation on the transfer of interests under OPLs and IMLs in that the new proposals appear to capture transactions higher up the corporate chain, imposing on them the requirement of Minister approval. This could deter or at the very least slow down corporate transaction activity in the sector.

Current status of the legislation

Despite these ongoing difficulties, the revised PIB has made some progress and Nigeria's House of Representatives and Senate have now reportedly finished the first and second readings of the revised draft. The next stage is the public hearing which was due to start in December, however the bill's progress is slow and commentators now expect this to take place in late January/February at the earliest, (the delay being blamed on many of the key PIB committee being involved in the approval of Nigeria's 2013 budget and therefore unavailable for PIB hearings late last year). Following the public hearing there will be a final vote on the bill in both the House of Representatives and the Senate.

If the revised PIB is passed by the legislature, the final stage is for President Goodluck Jonathan to give it his assent. He may of course choose not to assent to the form proposed by the legislature (and in this case the bill will require a two thirds majority to override such refusal)[9] but he will be under intense political pressure to give his assent and see the bill made law during his tenure as President, thereby ending the years of wrangling and uncertainty over the regulation of Nigeria's oil and gas industry.

Conclusion

Whatever the form the final PIB takes, the real test will be whether Nigeria will gain more from her natural resources while simultaneously maintaining an economic regime which can compete favourably with other oil and gas rich nations.

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Oil and Gas Asset-Based Financing: An Appraisal Of Security Structures For RBL Transactions Under Nigerian Law

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Introduction

Continuing divestments of oil and gas assets by Nigerian National Petroleum Corporation's Joint Venture partners, i.e. International Oil Companies ("IOCs"), have led to the emergence of a growing number of foreign-owned independents and indigenous operators as key players in the oil and gas sector.

Most of these divestments have been driven mainly by IOC's bid to evade the maturing onshore liabilities and the envisaged unfavourable profit-sharing arrangements in the Petroleum Industry Bill ("PIB").

It is noteworthy that a significant portion of the acquisition or development financing by these indigenous entities was sourced via debt funding.

In the acquisition of oil and gas assets by indigenous and other players from IOCs, a number of financing structures have been utilised post-acquisition to, inter alia, fund a substantial development of such assets as well as refinance debt incurred during acquisition financing. These include project finance and Reserve-based Lending ("RBL").

RBL, which originated from the United States of America, has been stated to be a hybrid of corporate, project and asset-based financing and typical structures include senior secured, stretch and mezzanine.

RBL facilities have thus enabled a number of the aforementioned oil and gas entities to leverage their balance sheet size to meet the financing exigencies of business including capital and operating expenditures.

This paper attempts an appraisal of the security structures that have recently been used in Nigerian RBL transactions including a recent US$470m RBL deal in which these discussants were involved. The paper also examines some knotty legal issues that have been encountered in some RBL transactions.

Definition of RBL

The Sumitomo Mitsui Banking Corporation, on its website proffered the following definition: "Reserve-based lending ("RBL"), also known as 'borrowing base' financing, in the context of oil and gas is a commonly used technique for financing assets which are already in production or where production is expected to commence shortly". RBL typically involves "*a non-recourse loan the amount of which is based on the expected present value of future production from the fields in question, taking account of factors such as the level of reserves, expected oil price; a discount rate; assumptions for operational expenditure; capital expenditure; tax and any price hedging employed*".[1]

Writing in chapter 17 of the 2012 edition of "The Principles of Project Finance", edited by Rod Morrison, Keith O'Donnell stated that RBL "refers to an asset-based financing technique that

is unique to the oil and gas sector. It is secured lending where the collateral is the revenue stream that the borrower has from oil exploitation contracts".

These discussants define a classic RBL as a hybrid type of limited recourse financing under which the lenders advance a loan to the borrower on the security of either or a combination of proven or probable, developed or undeveloped hydrocarbon assets and in which repayment is largely based on the strength of the cashflows from the oil and gas assets being financed.

Borrowing Base and Related Issues

The Borrowing base asset may include the borrower's undivided percentage interest in the OML, together with its interest under all related infrastructure, facilities and field documentation pursuant to the terms of relevant Joint Operating Agreement ("JOA") or Production Sharing Contract.

The maximum amount that may be borrowed under an RBL facility is set by the borrowing base, which the lenders determine by analyzing the reserve value of the borrower's oil and gas properties. Typically, the borrower will be required to provide a semi-annually reserve report prepared by a third party reservoir engineer nominated by the lenders.

The borrowing base amount will typically be "*determined by a cash flow analysis driven by the value of oil and gas reserves following technical due diligence*". This inter alia entails a consideration of technical and economic assumptions, an assessment of Net Present Values ("NPVs") of expected cash flows from the borrowing base assets using relevant computer modelling, and the application of an agreed discount rate.

According to U.S. Attorney Jeffrey Munoz, "the borrowing base will typically be somewhere around 50% to 60% of the value of the oil and gas properties evaluated in the reserve report. This percentage valuation is used to provide the bank with some cushion on the loan in the event that oil and gas prices fall, the oil and gas reserves that the reserve report evaluated are not actually present, or the borrower has some failure of title related to the oil and gas properties that were evaluated. This cushion will also help the bank recover any additional costs that it might incur in connection with a bankruptcy or foreclosure on the properties".[2]

Classification of Reserves

In relation to RBL transactions involving Nigerian entities, the lenders will typically lend on the basis of reserves classified as "2P Reserves" or "1P Reserves" which in relation to a Borrowing Base Asset ("**BBA**") may be defined as those quantities of petroleum which are deemed to be recoverable from the petroleum field comprised in such BBAs as either "Proved plus Probable Reserves" or "Proved Reserves".

As Nigeria lacks widely-accepted local classification guidelines, classification could be in accordance with guidelines prescribed by the SPE/WPC/AAPG/SPEE Petroleum Resources Management System developed jointly by the Society for Petroleum Engineers, the World Petroleum Congress, the American Association of Petroleum Geologists, and the Society of Petroleum Evaluation Engineers, last updated in 2007.

Alternatively, the 2007 SPEE (Calgary Chapter) CIMMP Canadian Oil and Gas Evaluation Handbook ('**COGEH**') has been utilized in the Nigerian RBL market as a standard for classification.

Security Structure under Nigerian Law

Typical Nigerian security structures, the effect of which derogates from the non-recourse flavour of a classic RBL will include but may not be limited to:

- First ranking charge over all of the shares in the borrower, held by the borrower's shareholders including new shares issued in the event of share capital increases;
- Domiciliation of proceeds of offtake arrangements involving the borrower;
- Assignment of the Borrower's rights under all commercial contracts, including receivables under offtake agreements and crude handling agreements;
- Lien on all accounts held with the Account Banks;
- Charge over the Borrower's accounts, receivables, rights and interests;
- Subordination of any existing shareholder loans; and
- First ranking fixed and floating charge over all chargeable assets and undertakings of the Borrower including its present and future rights and interest under all related insurance and reinsurance contracts to the security trustee. In relation to assignment of insurance rights, most lenders specify a "minimum rating criteria" from international rating agencies such as Standard & Poor's Rating Services for relevant insurers or reinsurers with which the agreed insurances will be maintained.

An appraisal of the assignment of an OML within the context of debt financing and a few of the above-mentioned security structures follows.

Assignment of OML

An assignment of a borrower's interest under an OML is subject to satisfaction of the conditions stipulated under paragraphs 14-16 of the First Schedule to the Petroleum Act, Cap P10 LFN 2004 ("Petroleum Act"). These conditions include the

Minister of Petroleum Resources (the "**Minister**") consenting to such assignment.

In granting consent, the Minister has to be satisfied that the:

- proposed assignee has a good reputation, is a member of a group of companies of good reputation or is owned by a company or companies of good reputation;
- proposed assignee has or has access to sufficient technical expertise, knowledge, experience and funding to continue the work programme of the oil mining lease; and
- proposed assignee is in all respects acceptable to the Federal Government.[3]

Failure to obtain the ministerial consent to an assignment may potentially prove fatal as was established in the recent unreported case of *Moni Pulo Limited v. Brass Exploration Limited* [4] to the effect that failure to obtain the required consent rendered the assignment inchoate under Nigerian law.

It is noteworthy that the bureaucratic and other bottlenecks associated with obtaining aforementioned ministerial consent and the fact that most lenders may consider the above conditions onerous make this security option an unattractive proposition.

Share Charge

Given the reluctance of lenders to take an assignment over the borrower's interest in the OML, a share charge over the borrower's percentage participating interest in the OML appears to be the optimal security structure in most RBL transactions in Nigeria. This enables the lenders to effectively take over the borrower company in the event of default. Pursuant to this charge, the shareholders of the Borrower waive any pre-emption or other rights which may restrict the transfer of the charged shares in the event of default to the security trustee. The shareholders also covenant to deposit the originals of their share certificates, together with a memorandum of deposit, coupled with undated share transfer forms relating thereto. This charge permits the security trustee to enforce the security over the shares on behalf of the lenders in the event of a default by the borrower under the facility agreement.

It is arguable whether the decision in Monipulo versus Brass Exploration Limited (supra) can reasonably be stretched to impose a requirement for ministerial consent in relation to the creation of a share charge. There is plausible reason to however argue that until actual default by the borrower necessitating enforcement, the creation of a security interest via a share charge does not amount to an "assignment" within the intendment of the Petroleum Act.

Assignment of Key Contracts

This is usually part of the security package and may include an assignment of the borrower's rights and benefits as well as the receivables or payment due under crude handling agreements or offtake agreements.

Domiciliation of Offtake Proceeds

Account domiciliation is also part of the security package, especially in relation to payments accruing to the borrower under certain key contracts including offtake agreements. Under this structure, the borrower irrevocably and unconditionally instructs the offtaker to domicile all payments accruing to it with the specified account banks until amounts owed by the borrower are repaid in full or receipt of notice to the contrary from the security trustee.

Security over Bank Accounts

Under this structure, the lenders seek to establish and retain controls over the charged project accounts and payment flows relating thereto.

Key Legal Considerations

Some legal issues of interest include:

a) Determination of Optimal Security Structure: From a structuring perspective, a key legal consideration will be to determine what the optimal security structure should be, especially where the assets securing the RBL facility in question are subject to existing security interests. Where part of the proceeds of the RBL facility would wholly be used to extinguish the borrower's existing indebtedness, it may be necessary to decide whether to trigger a release of existing security[5] or for the new lenders to join in the existing security package, especially where the security trustee remains unchanged. It should be borne in mind that a choice of the former will entail the preparation of new security documentation with its attendant cost implications.

b) Scope of Representations and Warranties: The scope of the representations, warranties and covenants to be furnished by the borrower under the facility agreement is a potential knotty issue. More especially where the borrower holds a minority stake and does not have the operatorship of the asset. Counsel for the borrower may attempt to limit the scope thereof given that it may be unreasonable for the borrower to be made to furnish any covenants or assume obligations beyond those it is capable of furnishing or assuming having regard to the nature of its interest in, and rights in respect of the OML.

(c) Request for Deletion: Request for deletion of provision in articles of association restricting transfer of shares in a private company to assure ease of transfer in an event of default. As the robustly-drafted share charge will typically contain sufficient protection for the lenders, it will not be reasonable for this request to be granted, especially if the borrower wishes to remain private.

Conclusion

Although a Standard & Poors' analyst has recently drawn attention to the fact that RBL are a weaker form of liquidity than traditional asset-based lending facilities,[6] this warning has evidently not diminished the attractiveness of this funding method to both lenders and borrowers alike, especially indigenous players, foreign-owned independents and marginal field operators.

Finally, the horizon for RBL transactions in Nigeria appears to be a promising one and it is hoped that continuing IOC divestments and other factors will cement the uniqueness of RBL as a financing technique of choice by entities in Nigeria's oil and gas upstream sector.

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[1] See http://www.smbcgroup.com/emea/eu/lending/index accessed on November 18th 2012

[2] See generally Munoz, J.S. "Financing of Oil and Gas Transactions" at http://tjogel.org/wp-content/uploads/2009/10/Munoz_Final.pdf

[3] Paragraph 16 of the first schedule to the Petroleum Act

[4] FHC/L/CS/835/2011 delivered 7th May 2012, per Okeke, J

[5] See generally, Ekwere, Nkem: Project Finance: Key Legal Issues Under a Partial Refinancing Transaction, published March 8th 2012 and accessible via http://www.businessdayonline.com/NG/index.php/law/cover/34099-project-financing-key-legal-issues-under-a-partial-refinancing-transaction

[6] See article captioned, "Unique Features In Oil And Gas Reserve-Based Lending Facilities Can Increase Companies' Default Risk." via http://www.researchandmarkets.com/reports/2271556/recovery_unique_features_in_oil_and_gas accessed on November 25th 2012.

Overview of the Business Rescue Proceedings in South African Law

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Background

A new Companies Act (Act 71 of 2008) as amended ("Act") became operative in South Africa on 1 May 2011. This Act introduced some novel provisions into South African law. In particular, a culture of rescue was introduced with the enactment of the "business rescue" process.

Business rescue has been recognised by the South African legislature as a significant feature of the Act. In fact, the Act has specifically provided that, among other things, it aims to "provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders" (section 7(k)).

The business rescue provisions of the Act are designed to facilitate the rehabilitation of a company that is financially distressed by providing for the temporary supervision of the company, and the management of its affairs, business and property, by a business rescue practitioner in substitution for the company's board and prior management; a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and the development and implementation, if approved, of a business rescue plan to rescue the company by restructuring its affairs (section 128(1)(f)).

The aim of business rescue proceedings is to restructure the affairs of the company in an attempt to ensure that the company continues in existence on a solvent basis or failing this, at least provides a better return for the creditors and shareholders of the company than would ordinarily result from a liquidation of the company (section 128(1)(b)(iii)).

Candidates for Business Rescue

Suitable candidates for business rescue are those companies that are "financially distressed". That is, a company who within the ensuing six months, will either not be able to pay all of its debts as they become due and payable or will become insolvent (section 128(1)(f)).

In order to determine whether or not the company is financially distressed, either of the above two possibilities must exist. A company should therefore apply a cash flow test, which equates to the so called "commercial insolvency" test, which assesses whether or not a company cannot pay its debts as and when they fall due for payment or a balance sheet test, which equates to the so called "factual or technical insolvency" test, which assesses whether or not a company's liabilities exceeds its assets.

Accordingly, the test for business rescue is a forward looking test. It being whether or not the company will become commercially insolvent or factually insolvent in the ensuing six months. Thus, a company that is already insolvent is not suited for business rescue.

In this regard, the court in the case of Welman v Marcelle Props 193 CC & Another [2012] JOL 28714 (GSJ) eloquently summarised the instance in which business rescue is appropriate. It provided that "business rescue proceedings are not for terminally ill close corporations. Nor are they for chronically ill. They are for ailing corporations, which given time will be rescued and become solvent".

Accordingly, business rescue is suitable for companies that envisage that they will be on the cusp of insolvency in the ensuing six months. At the first signs of financial distress, a company should consider applying for business rescue. Once a company is more than "financially distressed", options other than business rescue become more attractive such as liquidation or compromises.

But even if a company is financially distressed the South African courts have indicated, in a recent spate of judgments, that not all companies that are financially distressed are well suited to the process. Generally speaking, a South African court will need to be satisfied that the company has a business that will enable it to trade out its financial difficulty, that it has the makings of a sustainable business rescue plan and the support of financiers.

Entry into Business Rescue

There are two ways in which a company can be placed under business rescue, voluntarily, by the passing of a resolution to that effect by the board of directors of a company (section 129(1)) or compulsorily, with an application to court by any affected person (employee or its representative, shareholder or creditor) of the company (section 131). With regard to the latter, if there is no reasonable prospect of rescuing the company the court may dismiss the application and place the company in liquidation (section 131(4)(b)).

Important Features of Business Rescue

Moratorium

One of the most important elements of the business rescue process is the moratorium imposed on the institution of legal proceedings.

The Act makes provision for a general moratorium on legal proceedings, including any enforcement action, against a company, or in relation to any property belonging to the company, or lawfully in its possession, during business rescue proceedings (section 133).

The moratorium granted by this section is designed to provide the company with "breathing space" while the business rescue practitioner attempts to rescue the company through the preparation and implementation of the business rescue plan. Without this element, a creditor would be able to enforce its rights during the process or apply for the liquidation of the company. This would be in conflict with the very spirit and purport of business rescue proceedings and is accordingly not permissible in terms of the Act.

Post-Commencement Finance

Post-commencement finance ("PCF") is finance provided to the company once the company has been placed in business rescue.

The Act distinguishes between two types of PCF: that which becomes due and owing to employees during business rescue proceedings and funding which is provided to a company, during the company's business rescue, by means unrelated to employment (section 135).

The Act also provides that PCF may be provided in exchange for security and will be paid in preference to the claims of unsecured post-commencement financiers (section 135(2)(a)). Accordingly, a financier will only generally provide PCF if it will be guaranteed some form of security from a company in business rescue so that it's claim against the company will rank in priority to the claims of previously secured creditors or unsecured creditors, but behind the claims of the practitioner and the employees of the company.

Adoption of a Plan

A business rescue plan that has been adopted is binding on the company, and on each of the creditors of the company and every holder of the company's securities, whether or not such a person (i) was present at the meeting; (ii) voted in favour of the adoption of the plan; or (iii) in the case of creditors, had proven their claims against the company (section 152(4)).

However, a business rescue plan may provide that, if it is implemented in accordance with its terms and conditions, a creditor who has acceded to the discharge of the whole or part of a debt owing to that creditor (ie voted in favour of the plan) will lose the right to enforce the relevant debt or part of it (section 154(1)).

In other words, once a creditor has voted in favour of a business rescue plan, and provided it is adopted and implemented in accordance with its terms, the creditor will not be entitled to enforce its rights against the company for its claim, or a portion of the claim, once the company has finalised the business rescue process. Such creditor's claim will have been compromised.

Directors and Business Rescue

Business rescue has also become a topic of discussion among directors. When a company is "financially distressed", directors are obligated to consider either passing a resolution to place a company under business rescue or publishing a section 129(7) notice.

A section 129(7) notice is a notice in which a company effectively publicises that notwithstanding its position of "financial distress", it believes, for the reasons delineated in the notice, that it is not necessary to pass a resolution for the commencement of business rescue. Careful consideration should be given when sending out this notice as it may give rise to unintended consequences (ie potentially an "Act of Insolvency")

The reason business rescue is relevant to directors is because under South African law, directors can be held personally liable (by proceedings brought by creditors of shareholders of the company) or criminally liable for their conduct. One such instance in which a director may be held liable for his or her act or omission is if the director conducts the company recklessly, with gross negligence, with intent to defraud or for a fraudulent purpose (sections 22(1), 77, 214 and 218). A failure by a director to place a company under business rescue when the company is "financially distressed" may fall within the ambit of either of the aforesaid.

Involvement of Attorneys

Attorneys are well placed to assist all role players involved the business rescue process. In our experience, each role player, be it a creditor, shareholder or employee of the company in distress or the business rescue practitioner itself, always seeks the assistance of external legal counsel when considering its position within the process.

Werksmans Attorneys is at the forefront of business rescue advisory in South Africa and has a team dedicated to advising all role players on all aspects of the business rescue process.

State owned but not liable for State's debts

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In July 2012, the Privy Council delivered its judgment in the case of *La Générale des Carrières et des Mines v FG Hemisphere Associates LLC*, which will undoubtedly have wide ranging implications for those doing business with the governments of African countries or African State owned entities.

This case sets out the test, as it stands, to be used for identifying a separate entity when determining whether a State-owned entity can be sued for the liabilities of the State and when a State can be liable for the debts of a corporation which it owns. The ability to recover debts of the State from a State-owned entity (and vice versa) is now limited to "*quite extreme circumstances*".

Background

In 2004, *FG Hemisphere Associates LLC* ("Hemisphere"), an investor in distressed assets, purchased two arbitral awards rendered against the Democratic Republic of Congo ("DRC") as a result of two International Chamber of Commerce arbitrations (the "Awards"). The Awards, worth a combined value of roughly $100 million, are reported to have been purchased for around $3 million.

The Awards arose out of contracts entered into by the DRC with Energoinvest (an engineering company) to build a hydro-electric facility and transmission lines in the DRC. The DRC failed to meet its payment obligations to Energoinvest and arbitrations then ensued, which concluded with the Awards.

Hemisphere attempted to enforce the Awards against the assets of *La Générale des Carrières et des Mines* ("Gécamines"), a mining company located in Jersey and wholly owned by DRC.

The first instance and Court of Appeal decisions upheld Hemisphere's ability to enforce the Awards against the assets of Gécamines in Jersey. Gécamines then appealed to the Privy Council, which has now ruled in favour of Gécamines, preventing Hemisphere from enforcing the Awards against such assets.

The judgments of the Privy Council constitute "persuasive" authorities in England (meaning English Courts are not bound to follow them), however, in practice, the decisions are often followed as the justices of the Privy Council are usually judges of the Supreme Court – and this case was no different, as, each of the five judges is currently a judge of the Supreme Court. It is, therefore, difficult to imagine an English Court departing from this decision.

State immunity

The internationally recognised principle of 'State immunity' protects States from legal proceedings in other jurisdictions. For example, in England, the State Immunity Act 1978 gives foreign States immunity from the jurisdiction of the English Courts (which includes enforcement proceedings), except in very limited circumstances (for example, if the State has actually submitted to such jurisdiction or the proceedings are in relation to a commercial transaction entered into by the State). This includes departments of foreign States.

However, State immunity does not apply to any entity (a "separate entity") which is distinct from the executive organs of the government of the State and is capable of suing or being sued. There are circumstances where a separate entity may claim State immunity, but such circumstances are much more limited than when a State can claim State immunity as the proceedings must relate to actions of the separate entity done by it in the exercise of sovereign authority and the criteria for State immunity (as applicable to the State itself) must also apply.

A separate entity must therefore have legal personality in order to have immunity as part of the State. Conversely, an organ of the State may under certain circumstances have legal personality (and not benefit from State immunity, for example in respect of proceedings relating to commercial transactions).

The lower courts' decision

The lower courts determined in favour of Hemisphere on the basis of the common law test set out in *Trendtex v Central Bank of Nigeria* (1977), which held that it is necessary to examine the "functions and control" of the entity to decide whether it is an "alter ego or organ" of the State for the purposes of establishing whether State immunity applied to it.

The Privy Council's decision

However, the *Trendtex* test pre-dates the State Immunity Act 1978 and on appeal *Gécamines* questioned whether the *Trendtex* test for State immunity was appropriate for determination of questions of liability and execution. The Privy Council held that the test for determining whether a State-owned entity was liable for the State's debts should be the same as that for determining whether State immunity applied to that entity.

This approach reflects the need for full and appropriate recognition of the existence of separate juridical entities established by States, particularly for trading and/or investment purposes.

The Privy Council considered that there was no doubt that Gécamines had responsibility for operations in a sector of vital importance to the national economy of the DRC, but that may be said of many State-owned corporations in centrally planned economies.

Whilst Gécamines' assets originated in the State, once it acquired them, they became its own assets. Those in day-to-day charge of Gécamines' affairs were vulnerable to having any important decisions which they took reviewed and vetoed by other State authorities, but that did not mean that Gécamines had no real existence as a separate entity.

The starting point was that Gécamines was not a sham entity. It was a real and functioning corporate entity, having substantial assets and a substantial business including interests in over thirty joint ventures with outside concerns. It had its own budget and accounting, its own borrowings, its own debts and tax and other liabilities and its own differences with government departments. It was an entity clearly distinct from the executive organs of the government of the State.

The primary question in relation to Gécamines was whether the circumstances proved showed that its juridical personality and its apparently separate commercial assets and business were so far lacking in substance and reality as to justify assimilating Gécamines and the State for all purposes.

There was no justification for deriving from the instances of cases where Gécamines' assets were used for the State's benefit a conclusion that the two should for all purposes be assimilated.

The 'correct' test

The Privy Council held that separate juridical status is not conclusive for an entity to be considered a 'separate entity' and the entity's constitution, control and functions remain relevant. However, constitutional and factual control of the entity by the State and the exercise by the entity of sovereign functions do not convert a separate entity into an organ of the State – more is required.

Especially where a separate juridical entity is formed by the State for what are on the face of it commercial or industrial purposes, with its own management and budget, the strong presumption is that its separate corporate status should be respected, and that it and the State forming it should not have to bear each other's liabilities.

It would take "*quite extreme circumstances*" to displace this presumption. The presumption will be displaced if in fact the entity has, despite its juridical personality, no effective separate existence. An examination of the relevant constitutional arrangements, as applied in practice, as well as of the State's control exercised over the entity and of the entity's activities and functions would have to justify the conclusion that the affairs of the entity and the State were so closely intertwined and confused that the entity could not properly be regarded for any significant purpose as distinct from the State and vice versa.

Conclusion

This case will be welcomed by African States and African State owned companies alike. However, it should serve as a warning to those seeking to enforce against them.

This case highlights the importance of conducting proper due diligence of the counterparty to any transaction to establish whether it is a 'separate entity' or an organ (or a department) of the State, as this may have wide-ranging implications should the transaction go sour and redress is sought.

It is advisable to 'earmark' valuable assets against which enforcement may be sought and consideration should be given as to whether enforcement against such assets would be possible.

The political dynamic of many African countries also highlights the need to keep the status of the counter-party under review. For example, having contracted with a government department in respect of a certain project, if the functions and assets of that government department are then privatised and transferred into a separate legal entity, this could cause issues down the line if legal action is to be taken against that separate legal entity, as it would take 'exceptional circumstances' for the assets of that entity to be able to be used towards the satisfaction of any judgment or award.

Development Finance Institutions and their role in sustainable private equity investment in Africa

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DFIs, private equity and sustainability

Development Finance Institutions (DFIs) play a fundamental role in emerging markets. DFIs are financial institutions established by a single government (bilateral) or sometimes multiple partners (multilateral) to invest in private sector companies or provide lending. DFIs aim to invest in sustainable and profitable businesses in emerging markets and developing countries either directly, or through financial intermediaries such as private equity funds. DFIs are important for a number of reasons, including being catalysts for private sector investment with a higher risk profile, and the implementation and integration of environmental, social matters and governance ("ESG") policies in private equity investment in Africa. DFIs have significant influence on African fundraising in that nearly half of all funds in Sub-Saharan Africa have DFIs as investors.[1]

Africa has become a key area for emerging market investors including the DFIs. Private equity funds manage an estimated $24 billion of assets in Sub Saharan Africa, with South Africa accounting for nearly 60% of this.[2] DFIs choose to invest largely through private equity funds as they have the advantages of risk sharing, efficiency, expertise and efficiencies of scale, whilst challenges for DFIs include control and transparency.

DFIs are important in emerging market funds in that they often act as cornerstone investors, and thereby become the catalyst for and provide the momentum for a successful first close, which is a struggle for many emerging markets funds in today's climate, particularly first time funds. Potential investor confidence is positively impacted by the act of a DFI investing and DFIs can often lend credibility to emerging markets funds which have a higher risk profile. DFIs can afford to make higher risk investments, and in doing so exercise their expertise, prescribe certain standards and sometimes collaborate with other investors. Knowledge sharing, for example, of the Association of DFI (EDFI) members increases member efficiency of investment and has resulted in certain standardised ESG standards and exclusions lists being developed.

The importance of DFIs to private equity is illustrated by the fact that in 2009 multilateral DFIs committed more than $12.5 billion to private equity in Africa.[3] Annual DFI commitments have increased from $10 billion in 2002 to over $40 billion in 2010.[4] DFIs remain optimistic about investment in Africa through the private equity model and 92% of investors in

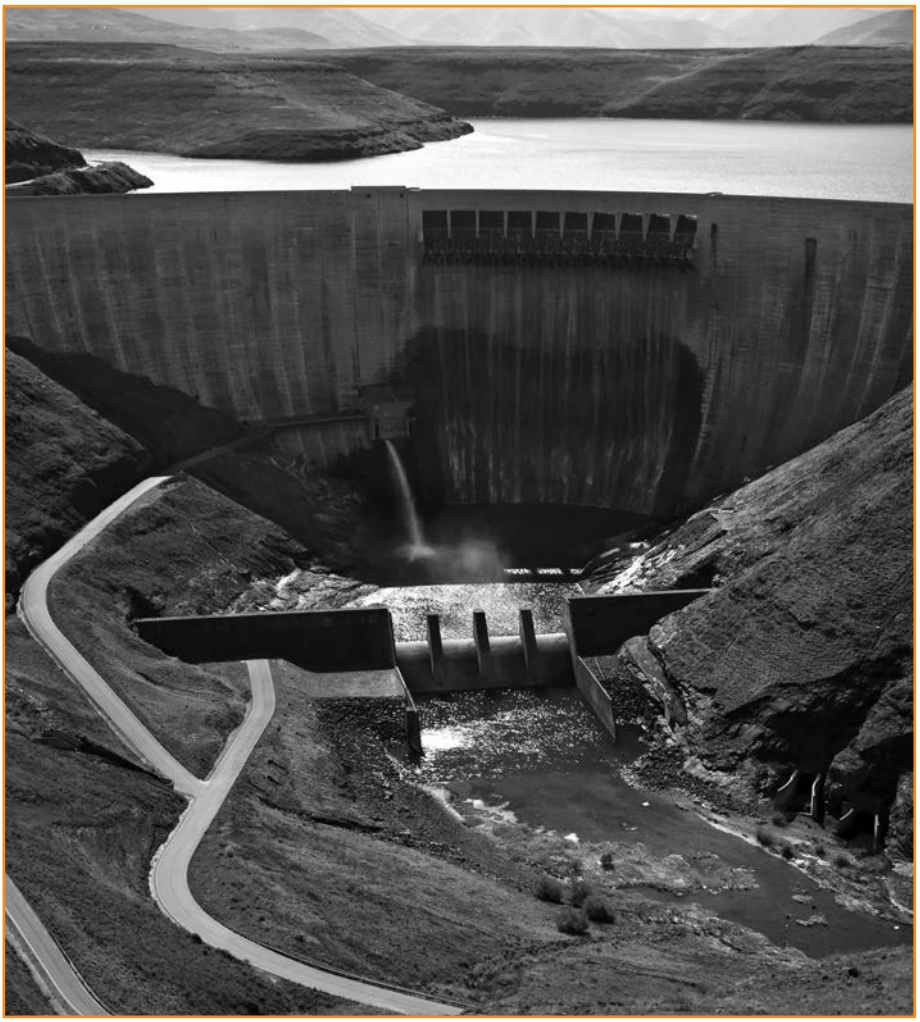
African based private equity funds intend to maintain or increase their investment in African private equity in the long term.[5] Given the weight of their investment and extent of their influence, the importance of DFIs in promoting sustainable development in Africa is evident.

Who are the DFIs and where do they invest?

The World Bank's International Finance Corporation (IFC) has proved to be the largest DFI investor in emerging markets, with other sizable contributors being EBRD, EIB, OPIC, GEPF and EDFI. EDFI is a group of 15 bilateral investment organisations, being BIO and SBI-BMI (Belgium), the CDC (United Kingdom), COFIDES (Spain), DEG (Germany), Finnfund (Finland), FMO (Netherlands), IFU (Denmark), Norfund (Norway), OeEB (Austria), Proparco (France) and SIFEM (Switzerland), SIMEST (Italy), SOFID (Portugal) and Swedfund (Sweden). EDFI investment is weighted towards Africa (34%) followed by Asia (27%), Central and South America (15%), Russia and CIS (7%) and other countries 11%.[6] DFIs have also invested widely across the sectors and sectoral distribution of the EDFIs is spread between financial services (31%), industry and manufacturing (29%) and infrastructure (26%), followed by agri-business (7%).[7]

What are the goals of DFIs?

The purpose of the DFI model is to provide "additionality", i.e. to provide finance or capital in areas and countries where there would otherwise not be access to finance or capital in the private sector, as well as ensuring catalytic impact, and that the impact is high and sustainable. DFIs believe that financial and developmental success go hand in hand and therefore view growth of the private sector as one of the keys to sustainable development.[8] Different DFIs place emphasis on different developmental challenges, including private sector growth and job creation, poverty reduction, improved health, education and environmental sustainability and social change.[9]



ESG standards have been developed by the IFC and EDFI and other DFIs. ESG standards, as interpreted and formulated by each member, have become prerequisite to investing in private equity for many DFIs. Fund managers are required to incorporate the ESG standards in their fund documentation and the ESG standards are integral to the principles and policies of the fund, the way each fund manager approaches each investment, and the actions of any portfolio company over which the fund exerts a controlling influence.

Although the focus on ESG has been ongoing for a number of years, it is estimated that only 1% of assets under management in South Africa can be defined as strictly ESG compliant, although using a broader definition of sustainable development, it is estimated that 20% of assets under management are sustainable.[10] There is clearly potential to broaden the sustainable investment base.

What is ESG ?

Although ESG standards are interpreted differently and emphasis placed on different areas for each DFI, the EDFI ESG guidelines set out general principles and objectives for sustainable and responsible investment which the fund is expected to comply with, ranging from complying with all applicable laws, to minimising adverse impact on the environment and employees and stakeholders of investee companies, focusing on and continuously improving on aspects including management of the

environment, social matters and corporate governance, applying international best practice standards and addressing E&S risks and realising E&S opportunities. Broadly, the EDFI ESG standards require that:

- extensive management systems are implemented, including processes for analysing investments in accordance with ESG standards and categorising levels of risk;
- the general partner ensures compliance by portfolio companies with ESG standards where the fund has control or significant influence in portfolio companies in which funds are invested. Compliance with all legal and regulatory requirements, maintenance of high standards of business integrity and compliance with EDFI corporate governance standards is required. Although this only applies where the fund has control or significant influence, the general partner will need to ensure that it implements effective management and HR strategies and remuneration standards in investee companies to ensure that the standards are adhered to;
- the fund and investee companies are required to work towards international best practice and standards in respect of environmental and social impacts. If negative environmental or social impacts are unavoidable then they must be mitigated or compensated for;
- the fund is required to provide transparent and accountable feedback and information in regard to ESG matters and is subject to ongoing monitoring; and
- environmental and social exclusions form part of the investment restrictions of the fund.

What is the impact of ESG on funds?

DFIs are willing and able to take the risk associated with emerging markets such as Africa, and also to invest in first time funds and are therefore key investors. It is therefore a necessity for fund managers to comply with ESG standards, however this is not without difficulty. Difficulties for fund managers in respect of ESG include extensive information gathering prior to investment and management of the investment in accordance with the ESG policy. The cost of implementing an ESG investment is therefore high, as is the cost of extensive management processes and ongoing monitoring and reporting requirements for the fund and investee companies. Fund managers, particularly first time managers who may have limited resources, may therefore find difficulty with implementation. The IFC and some EDFIs have recognised that some fund managers may require assistance in this regard, and offer technical expertise and financial support to implement ESG management systems. They actively provide in house training sessions, management toolkits and financial support to fund managers, as well as supporting investee companies in providing appropriate assessments.

ESG - measuring its impact

For sustainable development to continue its growth, it is clear that data needs to show that sustainable development results in positive financial returns. Successful impact is determined by the EDFIs on a number of key indicators, being direct and indirect developmental effects. Direct effects include direct employment, profits, government revenue, net currency effects, technical and know how enhancement and improved monitoring and work conditions.[11] Indirect effects include indirect employment, local and regional growth, supply chain growth, demonstration effects, increased competition and increased local infrastructure.[12] However the general lack of data and problems with measuring effectiveness of ESG are problematic. It is essential that investors and funds have mechanisms and infrastructure to measure investment returns and the ESG impact as currently there are arguments that there is a lack of evidence that sustainable investment increases financial returns.

Conclusion

Private equity can be a strategic driver of sustainable development in emerging markets. Sustainable development will assist in dealing with the numerous environmental and socio-economic challenges facing Africa today and DFIs are well placed to ensure that sustainability becomes the key to investment in Africa through implementation of ESG standards and given their importance to fundraising in Africa. The resulting sustainable growth will benefit Africa and its investors in the long term.

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1 Sustainable development in Sub Saharan Africa. IFC/Sinco/Riscure. (2011) p15

2 *Ibid*

3 *Ibid* p50

4 International Finance Institutions and Development through the private sector, EDFI

5 Development Finance Institutions investing in private equity, Prequin 2011, Bogusia Glowacz

6 The growing role of development finance institutions in international development policy. Dalberg (2010)

7 The growing role of development finance institutions in international development policy. Dalberg (2010)

8 World Business Council for sustainable development and SNV: Promoting Small and Medium enterprises for Sustainable development (2007)

9 International Finance Institutions and Development through the private sector, EDFI

10 Sustainable development in Sub Saharan Africa. IFC/Sinco/Riscure. (2011) p15

11 The growing role of development finance institutions in international development policy. Dalberg (2010)

12 *Ibid*

Private Equity in Africa: Pension Fund Reforms

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At the EMPEA Private Equity in Africa conference in October 2012, John Oliphant, Principal Officer and Head of Funds of the Government Employees Pension Fund ("GEPF") of South Africa, remarked on the need for regulatory reform across Africa to allow greater investment in private equity by African pension funds - a potentially significant source of funding for the private equity industry. In a previous edition of this newsletter in 2008 we considered the investment potential of Africa's pension funds and examined the domestic investment rules governing them. Since then much progress has been made in the liberalisation of pension regulations and to encourage more investment in alternative assets such as private equity. These regulatory changes have resulted in many African pension funds being able to invest in private equity for the first time.

Pension funds such as GEPF are also reporting increased approaches from private equity funds, which have long tried to convince pension trustees to make provision for this asset class. As a result of Africa's rising middle class, pension funds across the continent are increasingly being considered as key sources of capital for private equity fundraising and the sums that could be allocated to private equity are considerable. Nigeria's National Pension Commission ("PenCom") estimates the country's registered pensions to be worth approximately US$15billion (and growing by approximately 30% per annum),[1] whilst pension fund assets in Namibia were estimated to be over US$6billion.[2]

Yet despite the substantial reforms in the jurisdictions which we initially considered in 2008, the vast majority of the exposure to private equity in Africa is still borne by foreign institutional investors and development finance institutions rather than domestic pension funds. This article provides an update on the regulatory progress that has been made and considers some of the non-regulatory factors that prevent African pension funds from making greater allocations to private equity.

Nigeria

The potential for Nigeria's pension fund assets to be deployed in the private equity market has long been recognised and legislators have made efforts to establish the necessary legislative framework for domestic pension fund investment. There has been significant development since 2008, when the Regulation on Investment of Pension Fund Assets prohibited Nigerian pension fund assets from being invested in securities that were not listed on a securities exchange registered under the Nigerian Investment and Securities Act.

In December 2010, changes to the country's pension regulations were made, permitting up to 5% of fund assets to be invested in private equity or venture capital funds for the first time. On the basis of current estimates, this would amount to approximately US$800million being available for private equity funds.[3] As well as altering the upper limit for investment, the regulations have been amended to include private equity as a specified asset class for pension funds to invest in. In addition, PenCom has also made efforts to educate pension administrators about private equity, which has resulted in more interest in the sector.

South Africa

Private equity has seen the greatest pension fund investment coming from South Africa as a result of positive changes to pension regulations in recent years. The country's Pension Funds Act was reformed in 2011, with key amendments to Regulation 28 of the Act which sets out the allocation cap for various asset classes. South African pension funds can now invest up to 10% of their total assets in private equity (an increase from previous allocation caps of 2.5% for investments in unlisted shares outside South Africa and 5% for unlisted shares within South Africa). This has meant that pension funds like GEPF, Africa's largest pension fund, can now commit up to an estimated US$9billion to private equity.[4]

The Public Investment Corporation ("PIC"), GEPF's asset manager, could now commit up to US$3.8billion to African private equity alone following these reforms.[5] This was confirmed by John Oliphant as a means to diversifying away from South African equities. However, there are calls for South African pension funds to invest more in private equity – as at 2012, it is estimated that despite considerable GEPF investments, less than 1% of South African pension fund assets under management ("AUM") was invested in private equity.[6]

Kenya

Since 2008, Kenya's Capital Markets Authority ("CMA") and Retirement Benefits Authority ("RBA"), the country's regulatory bodies, have been reviewing allocation limits that restrict the ability of pension funds to invest in private equity. Under the Retirement Benefits Act 1997, Kenyan pension funds should be able to invest up to a maximum of 10% of their assets in private equity funds through the "other" asset category and this requires approval from the CMA. This is potentially in addition to a 5% allocation to unquoted

shares of companies incorporated in Kenya and collective investment schemes incorporated in Kenya, although this would be unusually high if aggregated. CMA has recognised the potential for these funds to make a significant impact on the private equity sector and proposals have been put forward for the removal of the approval requirement and for private equity to have a separate investment cap (although it is unclear what the new maximum limit would be).

The Kenyan regulators also intend to address some of the other obstacles that limit pension fund investment in private equity. For example, there are plans to provide private equity investors with an exit mechanism to unlock the value of their investment by allowing private equity funds to list on the Nairobi Stock Exchange, a move which will help to reduce the liquidity concerns of pension fund trustees.

Namibia

Namibia, a country with one of the highest saving rates in the world, is currently in the process of devising a private equity policy to take advantage of the country's considerable domestic savings. As at September 2012, the Namibian Government Institutions Pension Fund ("GIPF") had already allocated over N$320million in private equity investments.[7] The Namibian private equity policy is being developed through detailed studies on global private equity practices and perhaps this can serve as an example for regulators across Africa that are looking to realise the investment potential of their domestic pension fund assets.

Regulatory limits in other jurisdictions

Similar efforts have been made to mobilise pension fund capital for private equity, by increasing limits or creating new limits have been made elsewhere in Africa, including Ghana, Uganda and Senegal. Statutory restrictions on pension fund private equity investments have a valuable role to play in the safeguarding of domestic savings and such regulatory caps are common in many jurisdictions outside Africa including Germany, Denmark and Italy.

However, looking at global private equity allocations it is clear that protecting domestic pensions is not simply about statutory limits. It is important for a pension fund to make the best investment decision based on the underlying private equity manager's ability to generate a high risk-adjusted return. For example, the California Public Employees' Retirement System (the largest US pension fund) had a 2012 private equity allocation of 14.1&% of AUM which exceeded statutory limits seen elsewhere. However the Dutch ABP pension fund (the largest European pension fund contributor to private equity) allocated approximately 5% of its AUM to private equity, which would be within these limits. Despite positive legislative developments, it is the negligible figures of actual allocations to private equity by African pension funds that need to be addressed.

Non-legislative obstacles to private equity investment

Legal reforms will allow for greater investment in private equity, however, African pension funds will remain

underweight in this category (as the situation in South Africa demonstrates) unless more is done to tackle the non-legislative changes that are needed to increase allocations from pension fund trustees.

For example, Marang Denalane of the South African private equity firm Sphere cites the private equity 'J Curve' (the tendency for private equity funds to deliver negative returns initially, with investment gains being seen in later years) as a major hurdle for pension fund trustees.[8] Another barrier is the lack of understanding of private equity and unfamiliarity with the asset class amongst pension fund trustees.

Even in South Africa, with its sophisticated financial markets, many pension funds have limited experience of investing in private equity. Until trustees become more familiar with the asset class, significant participation in private equity will remain unlikely. Related to this is risk aversion amongst pension fund trustees, which is often cited as another obstacle. Pension fund managers are inherently conservative and prefer to invest in lower-risk asset classes such as listed equities, fixed-income securities and treasury bills.

According to PenCom, the need to safeguard pension funds takes priority over the demands for pension funds to maximise returns.[9] Additionally, in comparison with listed securities, private equity is a more illiquid asset class (with investments being made for at least five years on average, or longer in Africa), and this sometimes poses a major issue for pension fund trustees concerned about the potential for this to restrict their ability to meet their liabilities to members when these fall due.

The case for increased pension fund allocations to private equity

Private equity has historically enjoyed strong returns (often outperforming listed securities) and is now a key part of the investment strategy of many global pension funds. However, the unique characteristics of private equity funds and their suitability in terms of pension fund investment strategies will need to be successfully addressed before the market sees a change in the investment mandate of African domestic pension funds.

Notwithstanding this, many of these perceived drawbacks can be offset by the high investment returns and diversification benefits on offer. Performance numbers support the argument for increased private equity allocation and in particular private equity in Africa, which in countries such as South Africa has outperformed developed market figures.[10]

Private equity in Africa offers the continent's pension funds opportunities to realise outsized returns. For example, the International Finance Corporation ("IFC"), has reported that its Africa portfolio has historically outperformed its entire emerging markets portfolio and according to an EMPEA/Coller survey, emerging market investors with exposure to Sub-Saharan Africa in particular have come to expect higher returns than those without.[11] Private equity investments typically have a low correlation to listed equity securities and so they can help to achieve broad sector diversification for a pension fund's portfolio.

Savings vehicles such as pension funds have proved to be more than capable of managing the lengthier investment term and limited liquidity of private equity. Private equity is a long-term asset class, with managers looking to create value in 5 to 7 years, whilst pension funds set assets aside to meet long-term future liabilities, thus they are comparatively well suited to the liquidity profile of private equity. Additionally, even when considering global pension commitments (with average allocations of between 10% and 30% of total AUM), the small size of private equity allocations is such that illiquidity can be managed. Moreover, the nature of private equity capital calls means that only a certain amount of an allocation to private equity is deployed at any given time and the regular payments of dividends and interest during the life of the fund will also help to mitigate liquidity issues.

Crucially, in the context of African private equity, domestic pension funds have the potential to change the continent's private equity landscape by assisting high-growth local businesses. Investing in an unlisted company can often have a significant economic and social impact, and there is evidence to suggest that private equity can directly improve livelihoods through job creation and GDP growth.[12] Although socio-economic impact is not a pension fund's primary objective, it should be recognised as a positive aspect of private equity allocation for national pension funds. Increased domestic investment could also have a catalytic role in attracting further international capital for Africa-focussed private equity projects. The global investment community's desire to play a greater part in Africa's growth story will be encouraged if the risks taken in African private equity investment are shared between foreign institutional investors and their counterparts at a local level, with pension funds able to pave the way.

Developments to target pension funds

The private equity industry is developing investment strategies targeted at pension funds, and private equity managers have been taking a more proactive role in effecting change. For example, GPs have been working on Nigeria-focussed

funds in order to take advantage of the new rules which stipulate that 75% of the assets of any beneficiary private equity fund must be deployed in Nigeria. Similarly, Old Mutual designed the South African OMMMPEF1 fund specifically with institutional investors such as pension funds in mind; this fund has featured a low minimum investment and a liquidity option to allow investors to exit before the fund matures.

Trustees, legislators and other stakeholders should also be educated about private equity to allow them to fully understand the industry and evaluate how private equity can be incorporated into their investment strategies. In order to do this, throughout 2010 and 2011, the Commonwealth Secretariat, the African Venture Capital Association and other private equity stakeholders organised regional private equity roundtables in Namibia, Ghana and Botswana to introduce institutional investors to private equity and identify how best to promote domestic participation in the industry.

Conclusion

The regulatory changes that have occurred in the African pension sector represent a major opportunity not only for the private equity industry but for the continent as a whole. Many see this liberalisation as the key to releasing domestic capital to support Africa's continued growth through African private equity – a chance for direct reinvestment. This changing attitude is exemplified by the South African Treasury's statement that a key aim of retirement fund investment regulation is to ensure that national savings are "channelled in ways that achieve economic development and growth".[13] This will allow fund managers such as John Oliphant of GEPF and other similar institutions to gradually invest further in private equity, both in South Africa and across the continent.

The African pension sector has the potential to drive economic growth, and the aforementioned pension reforms will go a long way towards achieving this. There is however more to be done apart from rules reform. Governments, pension fund administrators and private equity stakeholders should continue to work together in order to tap into the growing wealth of African citizens and spur further endogenous development.

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Angolan Foreign Exchange Rules for the Oil and Gas Sector

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In early 2012 the Government of Angola passed Law No. 2/12 de 13 de Janeiro (the "FE Law"), establishing a new foreign exchange regime for the domestic oil and gas sector. Implementation of the FE Law began in October 2012 but what do these new requirements mean for stakeholders in Sub-Saharan Africa's second largest oil producing country?

Background

Oil production accounts for approximately 45% of Angola's GDP. International oil price volatility in 2009 caused a domestic macroeconomic crisis with unprecedented fiscal consequences. However, following a significant recovery in 2010-11, the Angolan government has introduced the FE Law to tackle the economic weaknesses that were exposed in 2009. In an attempt to bolster the domestic banking sector, the FE Law primarily obliges oil companies operating in Angola (the majority of which are foreign) to use Angolan banks to complete financial transactions.

Highlights of the FE Law

Under the new regime, Sonangol (the state-owned national concession holder) and its foreign and national associates (together the "Energy Partners") must process all payments out of Angolan bank accounts regardless of the foreign exchange residency of the contractor or supplier. The Energy Partners must also maintain two bank accounts in Angola - one in USD and one in Kwanza – from which to pay foreign and domestic suppliers respectively. Sums must also be deposited to cover the Energy Partners' various tax obligations.

The FE Law further provides that upon compliance with tax obligations and payment of cash-call expenses, non-resident concession holders may freely allocate the balance of the USD account to the national or international markets. Furthermore, amounts that are to be distributed as profits, dividends, incentives and/or other capital or investment return may be deposited abroad by non-resident Energy Partners whereas national Sonangol associates may only deposit these amounts in Angolan banks. Any payments for goods and services provided by resident contractors and service providers must be made in Kwanzas.

Role of the Banco Nacional de Angola (the "BNA")

As under the old regime, the BNA acts as the foreign exchange watchdog. Accordingly operators in the oil and gas sector are required to submit quarterly and annual reports to the BNA listing, among other things, all agreements entered into with non-resident foreign exchange parties together with budgetary forecasts. In compliance with its obligations under the FE Law, the BNA recently issued Aviso No. 20/2012 detailing the implementation mechanisms and timetable. The Aviso anticipates full implementation of the FE Law by late 2013, a deadline described as "ambitious" by the IMF in its Country Report no. 12/215 (the "IMF Report").

Conclusion

From a broad commercial perspective the new law will impact on foreign investment into the Angolan oil and gas sector, whether by investment funds, financial institutions or multi-nationals or other traders in the sector. The law should enhance the efficient collection of withholding or other taxes and duties but will also need to be factored into structures looking to return value to investors or shareholders given that the law resets the "local content" requirement for foreign entities.

The jury remains out on the effects of the new FE Law. As detailed in the IMF Report, the law has the potential to increase financial intermediation and expand the range of financial products available to support the domestic economy. However, several aspects related to the scope and timing of implementation still need to be carefully understood and analysed.

For more detail on any of the issues raised in this article, or to discuss the impact the FE Law might have on your business, please contact the author.

Fitness For Purpose in MENA Projects

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The concept of Fitness For Purpose ("FFP") is encountered more often in the Middle East and North Africa (MENA) than anywhere else. The first reason for this is the extensive use of FIDIC forms for almost every kind of project; and both the FIDIC Yellow Book (Plant and Design/Build) and the Silver Book (EPC/Turnkey) expressly require FFP. Although FIDIC forms are essentially engineering contracts, they tend to be used across the board. The second reason is that MENA projects include such a high proportion of power plant construction, petrochemicals, water desalination and other industrial process plant. These "active engineering" projects are thought to be easier to prescribe in terms of their specified end purpose, as opposed to static infrastructure such as roads and bridges. The big question is whether it is useful to prescribe project objectives in this way or does it simply cause trouble?

In the past, contract negotiations in MENA projects might have passed over FFP and other slightly odd-looking legal terms without too much concern. The trend now is for greater scrutiny of all contract terms and FFP is causing the same anxiety here as it does elsewhere. Typically FFP is at the top of both the Owner's list of "must have" items and the contractor's "must avoid" list. It has become an issue of principle rather than an obligation with practical implications. This is unfortunate because the legitimacy or otherwise of a FFP obligation depends on many factors, and position-taking is not helpful.

It is perhaps a good time then to take a dispassionate look at the usefulness of FFP because it suffers from a degree of misunderstanding. The concept can generate heated arguments which are, in practical and legal terms, meaningless. One of the reasons for the confusion is that FFP is borrowed from another part of English law – the law on sale of goods which has a statutory implied term that sold goods will be fit for their intended purpose. The result is an implied strict liability on sellers if their goods are not suitable for their intended purpose. In the construction world this applies to design-construct contracts including EPC. Even where those contracts do not include an express FFP obligation there is usually an implied such obligation where the Owner makes clear at the outset:

(i) the specific requirements of the completed works; and

(ii) that the Owner is relying on the contractor's expertise to achieve the requirements.

So unless the contract expressly excludes FFP, this obligation will usually be implied on a design-construct contractor. Contract negotiation on FFP in EPC contracts tend to take the following route:

(i) The Owner insists on FFP because it is both fair and the "market position" as evidenced by the fact that it is implied by general law and is written into the most commonly-used standard contracts. Owners also make the practical point that the completed plant "has to work"; otherwise they and everyone behind them has lost money. This is obviously true but doesn't address the question of whether the same objective can be met through other means.

(ii) Contractors tend to argue first that the intended purposes (stated or implied) are too wide and/or vague and are therefore an unmanageable risk. Some contractors argue that it is fundamentally the wrong way to specify EPC works and that the law on implied FFP is anomalous and unfair on design-construct contractors because there is no similar implied obligation in either professional design appointments or traditional (build-only) construction contracts. FFP is also said to be "uninsurable". It is also correctly pointed out that the Owner is often not relying on the contractor's expertise in any real sense due to the modern practice of Owners getting the works designed pre-tender. The construction contract may ostensibly be on EPC terms but the contractor is really just required to check the design and adopt it. Contractors usually cannot pass down FFP into sub-contracts, design appointments and supply agreements. All of these arguments are deployed in favour of the contractor's design obligations being set in terms of "reasonable skill and care", similar to a professional design consultant.

These arguments are interesting but not decisive for or against FFP.

The idea of "fairness" has more weight in the MENA than elsewhere and academic arguments about the implied English law position do not cut much ice. The argument on insurance ignores or intentionally avoids the fact that professional indemnity cover will only ever respond in the event of failure to meet a professional design standard of skill and care. This cover is not removed (or should not be) where the contract requires FFP; it is simply that the professional indemnity policy does not recognise failure on FFP as triggering the cover. If FFP does cause

wider insurance problems for contractors I suggest that this needs to be addressed in the policy conditions and not in the construction contract.

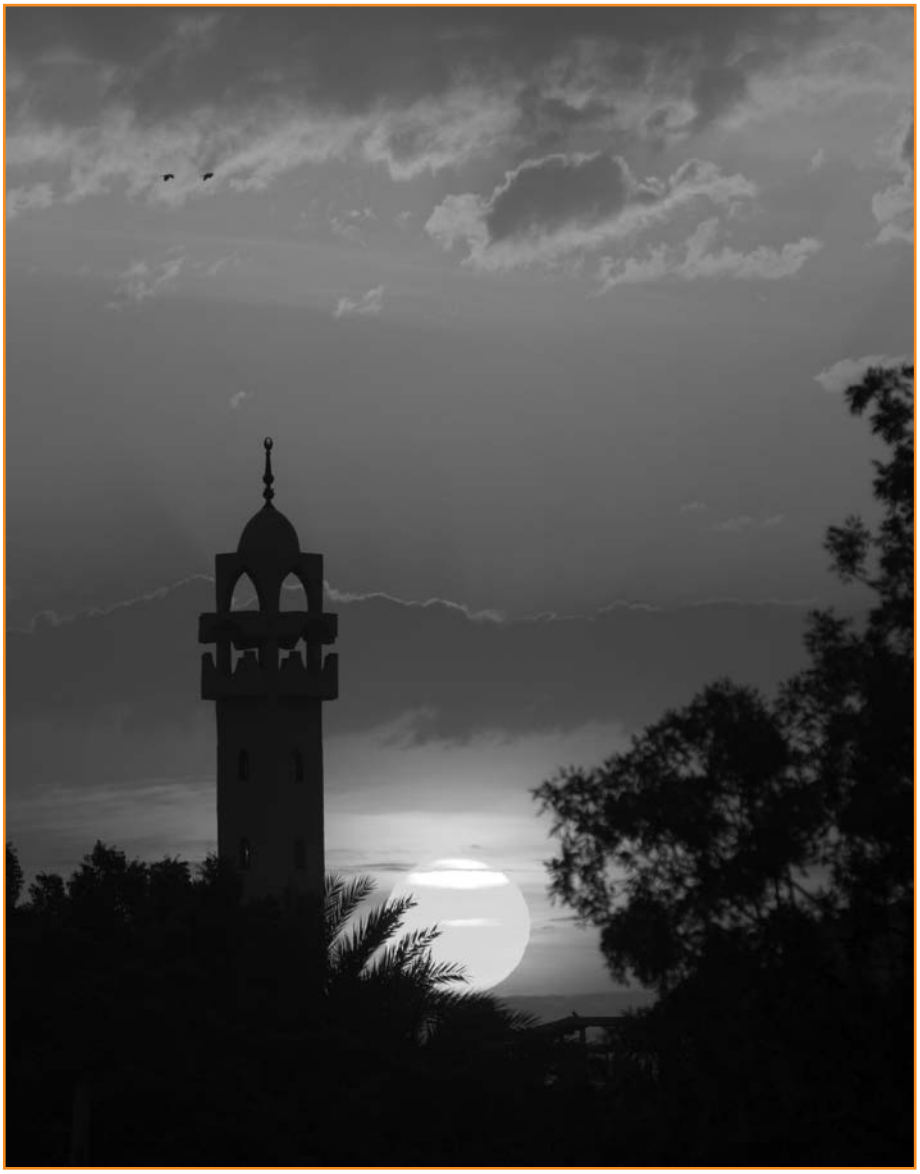
The best objection to FFP is lack of clarity: an obligation to make fit for generally-stated or implied purposes creates too much uncertainty in all but the very simplest of projects. In many instances the "purpose" is inadequately stated and is often not capable of being adequately identified in the post-completion testing regime. This does not meet either party's needs.

Why then do Owners try so hard to include it? FFP is sensitive because it touches on the one task which an Owner in an EPC contract simply cannot pass to the contractor. That is the task of stating exactly what the Owner wants. This obviously carries the risk of getting that statement wrong. Even the strongest and strictest fixed price EPC cannot place this risk with the contractor, although some interesting ways are attempted. Some Owners do not want to hold the risk of stating what is wanted in terms of a physical specification and a performance specification together with devising the inspections and tests required to identify whether those specifications have been met. Owners and their professional teams often see FFP as a blanket solution to those problems and for the same reason they will try to set a wide definition of intended purposes. This is a compound mistake.

So what should happen?

In order to avoid repeating the same arguments on both sides in contract negotiations we need to look at FFP in more basic terms and recognise the differences between construction contracts. EPC contracts are based largely on output obligations - performance specifications, performance guarantees and performance tests. Other design-construct contracts may be based largely on inputs - quality of work and materials and quality of design in terms of reasonable skill and care. FFP is an output obligation and it is often a red herring in EPC contract negotiations.

In EPC, the usual debate about FFP versus "reasonable skill and care in design" is often sterile argument. In order to work properly, a true EPC contract should not require either of them except in particular circumstances where a testable performance specification is somehow impossible. The key to using EPC is to decide at the outset what is required from the contract in practical and performance terms, by when and for how long. In that situation, most of the design obligations are sense redundant. The contractor will of course design and will carry out all other inputs required; not for their own sake but in order to fulfil his core obligation, which is to meet the physical and performance specification under testing.



In an ideal EPC set up the Owner has fully set out the performance requirements for the completed plant in terms of output (of power or ethanol or clean water or whatever) together with the other performance and consumption metrics in given test conditions for a given period. The timing of those tests, the technical parameters, the consequences of plant "Acceptance" the default procedures on initial failure and the damages or other consequences on sustained failure are all set out, together with the "warranty period" on both functional aspects and construction defects.

In this "standard" EPC set up the value of a separate FFP obligation is not clear if it is present simply to repeat those obligations on performance guarantees and the warranty period. If a FFP provision seeks to change or add something, the questions are what and why. Sometimes there are good intentions, for instance to deal with achieving longer warranties, overlapping contractor-operator liabilities and longer term operational efficiency. This is a big and topical issue now that we are seeing more attention on "whole life" procurement, concession models, Design Build Operate, linked long term service contracts from equipment suppliers etc. There is an array of useful models (and hybrids between them) devised expressly to achieve effective plant construction and performance over long periods. Even within the basic EPC model, tests can be conducted over long periods; they might be delayed, split, repeated etc. prior to final plant Acceptance, and there can be longer warranty periods. There are no limits here if Owners and their advisors want to run longer and integrated construction-operation obligations and they are prepared not to be constrained by conventional contracting models. For those objectives, FFP is a blunt instrument.

Negotiations on FFP therefore usually miss the point because the discussion really should be about whether the right sort of contract has been chosen. This depends on whether the works can be fully performance-specified and performance tested. If not, maybe EPC is the wrong contract. In the MENA, as everywhere else, FIDIC is just one way of getting things done.

In conclusion, FFP can be useful in a construction contract where this is the best way to express what is required. This might apply in building works, for instance commercial real estate development where building function needs somehow to be expressed. In building works, the quality and amenity of the completed building is mostly not tested but observed over a longer period – and the period of post-completion liability for contractors usually lasts for years. Engineering projects are specified differently and have generally shorter periods of residual contractor liability post-completion.

There is a role for FFP in many projects but unfortunately it is often used in EPCs as a fix for two problems, being inadequate performance specification and lack of connection between build and operate phases. There are better solutions to those problems.

Getting MENA and Africa connected with offshore cables

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Most people assume that when you send a message on your mobile to someone abroad or watch a video that it goes via satellite. Actually, 95% of the time, the data is carried by fibre optic cables across the sea floor.[1] Africa and the MENA region are in the process of being connected with the rest of the world through these cables. Increasingly these links are cost effective and consortia are being formed to increase the availability of such telecoms routes.

Increasing bandwidth capacity is important to Telcos, non-governmental sponsors, governments and development finance institutions alike.[2] The availability of local offshore cables helps users across MENA and Africa gain access to voice, data, web-based video and multimedia-centric websites. So, it offers the promise of making businesses in the region competitive with the rest of the world. As these populations spend more of their time online - data usage will only increase.[3] One of Deloitte's predictions for 2012 was that this would bring an increase in caps on data downloads.[4] Investment across the region in on-shore cabling, data centres and masts will start to bring universal coverage closer to reality.

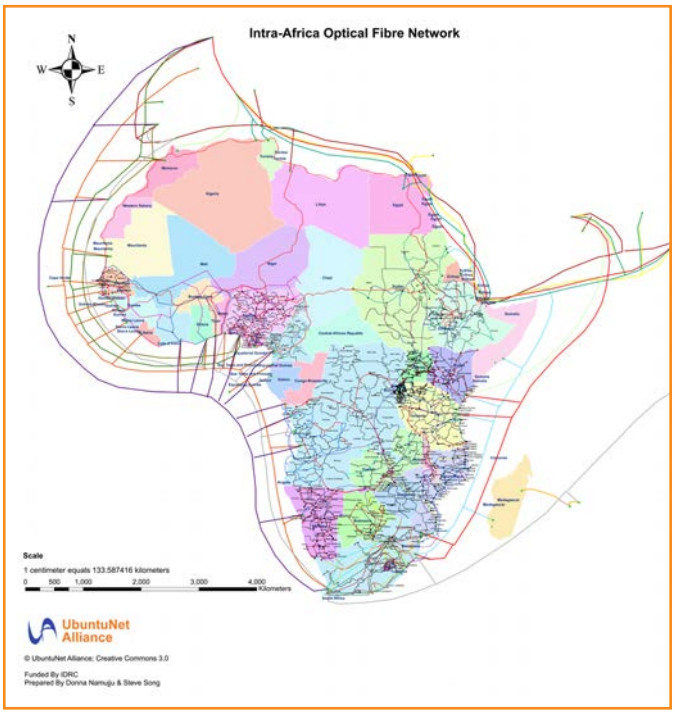
Putting a consortium together

The complexity and cost of laying the cables is generally too much for one company. Consortia come together to pool their resources and share the risks in the project.[5] Consortium members can then sell spare capacity to third party buyers or use it for their member networks. There is no standard way of drawing up a consortium agreement. Each project is unique and is structured differently both from a debt and equity perspective. Regardless of the type of consortium that the parties select, it is vital to craft a cohesive and well-structured contract.

Developing infrastructure - common problems and unique issues

Developing a submarine cabling system is similar in many ways to other infrastructure developments like pipelines and rail projects.[6] The documents include the usual construction, design and maintenance agreements, a consortium agreement and sometimes a separate shareholders' agreement, equity commitment letters and a whole suite of financing documents.[7] Most of the larger companies operating in the submarine cabling industry work to international standards under the ISO 9000 and ISO 9001 schemes. In addition, the International Cable Protection Committee publishes recommendations on key issues such as cable routing, cable protection and recovery.

Such projects also have unique elements, examples of which are set out below.



1. Permits

A project extends for thousands of miles and the acquisition of permits and landing rights depend on local law. Many GCC countries and African states view telecoms as a vital sector. It is common for states to insist that the cable landing rights and other permits are only granted to companies that are predominantly locally-owned businesses. For instance, a MENA Cable system - linking Italy, Egypt, Saudi Arabia, Oman and India is currently progressing.[8] There had been initial claims that it had been halted due to the difficulty in obtaining certain government permits.[9]

2. Cable repair and maintenance

Parties must consider early on the cable repair arrangements and the cost of dealing with breaks in the line caused by weather conditions, trawlers or seismic activity. In early 2012 breaks in EASSy and TEAMS cables disconnected about half the networks in Kenya and Uganda from the internet – resulting in claims.[10]

3. Tax and structuring issues for the consortium

From the consortium's perspective, the sponsors will try to minimise the amount of taxes payable. This is often achieved by locating the principal cable owner in an offshore tax jurisdiction. Careful consideration must therefore be given to the structuring and the length of time it will take to get the project operational. More importantly for sponsors, the taxing of revenues and environmental considerations are unique to each project.

4. Which set of laws to apply

In addition, the applicable law may vary depending on whether the cable is on-shore, in territorial waters or on the high seas.[11] There are also complex issues of public international law which can arise. It is essential for the sponsor to appoint a team of advisers who understand the issues involved and can manage the international scope of the project.

5. Resolving disputes

Disputes often arise as costs escalate beyond the original plans. Ensuring that these disputes do not throw the whole project off-course is critical. A neutral governing law clause and jurisdiction is typically chosen so as not to favour one party. Arbitration rather than the courts is also a common choice. The principal benefits are:

- Neutrality - none of the parties can influence the outcome of the decision;
- Privacy - hearings are held in private in most cases;
- Tribunal - can have sector specific expertise which is particularly relevant for these projects; and
- Final and enforceable decision - this is particularly relevant in the MENA region.

6. International regulation

The United Nations Convention of the Law of the Sea ("UNCLOS") governs much of the law relating to submarine cables. UNCLOS has been ratified by all GCC and most African countries. International regulation and co-operation in this area are showing reasonable signs of progression. Earlier this year, delegates from 35 African countries met to develop guidelines on how to access submarine cables anchored in different countries. One of the aims was to ensure equal access to cables across the continent at a reasonable cost.

Conclusion

Making a consortium work requires careful planning from the outset and a reasonably lengthy investment of time. This is particularly the case within submarine cabling where there are complex issues of local consents, international law and enforcement of rights at stake. As the region opens up further to local and foreign investors - there will be opportunities aplenty for those with some understanding of the issues involved.

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1 In some countries, particularly land-locked countries like Congo – approximately 89% is still carried by satellite – see page 9 of end note 4

2 See in particular the World Bank's Report Broadband for Africa : developing backbone communications networks - Williams, Mark D. J.;

3 Costs are also predicted to come down for bandwidth. See World Bank Report pp xv - average price of broadband in Sub-Saharan Africa was $366 a month

4 TMT Predictions 2012, Deloitte, pp 40-41

5 EASSy, for instance, has been developed by a consortium of more than 20 telecommunications operators, predominantly from East Africa and southern Africa, with the help of 5 DFIs

6 Average fixed line penetration in the region is currently less than 2% - see World Bank report referred to at 3 above

7 In the case of EASSy, the cable that connects South Africa to Sudan, each of the IFC, EIB, ADB, AFD and KfW lent money the special purpose vehicle to develop the project

8 Article: 'Works under way in MENA Submarine Cable System' from www.zawya.com on 29 May 2012

9 Article: ('Orascom suspends MENA Cable Project') from www.zawya.com on 14 May 2012

9 Article: 'TEAMS sues KPA for USD 15 mln over cable cuts', 30 April 2012 from www.telecompaper.com

10 The SAT-3 cable that runs along the West African coast each had the exclusive control to cable in its own country (see endnote 4 page 55)

11 Article: 'Africa: Continent Calls for Harmonised Policies on Submarine Cables' from www.allafrica.com

SJ Berwin Paris triathletes and Mika

In 2012, a group of lawyers from the SJ Berwin Paris office, in a collaboration with the French charity Mécénat Chirurgie Cardiaque Enfants du Monde took part in a triathalon in Paris to raise funds to enable a young Madagascan child, Mika, to have heart surgery in France.

The efforts of the SJ Berwin triathletes and the generosity of their sponsors, including other SJ Berwin staff members as well as clients of the firm who all donated to the charity led to Mika receiving successful treatment. Mika returned to Madagascar in full health and without the need for any follow-up treatment, which all at SJ Berwin are extremely grateful for.

Mika with the family that kindly accommodated him and took care of him during his French journey

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The SJ Berwin Africa Group recently strengthened its Finance offering with the appointment of Chris Fanner to the partnership in London.

Chris is a well-respected and highly rated Finance lawyer and whilst his primary practice area for most of the last 20 years has been financial sponsor originated leveraged finance, structured emerging markets and infrastructure finance, Chris also has a significant telecoms finance practice, particularly in Africa. His client base includes investment and lending banks and financial institutions (often advising lead arrangers on innovative and ground breaking structures) as well as mezzanine funds, private equity funds and corporate borrowers.

Chris' experience in Africa includes advising:

- Nedbank and Investec on the project financing for the US$700 million Seacom undersea cable connecting South Africa, the East African coast, Europe, the Middle East and India, involving equity support provided by FMO and EAIF;
- Citibank and Standard Bank as arrangers of a €93 million syndicated bridge facility and syndicated secured multi-sourced long term limited recourse finance for MTN Cameroon with other facilities supported by African Development Bank and FMO; and
- Nedbank, the Development Bank of South Africa and Investec on the $400 million long-term financing of the roll-out of the Neotel cable network in South Africa.

Chris and his team also have experience in debt capital markets such as issuing of Eurobonds and GDR programmes.

Chris is a regular speaker at conferences on banking and finance and he is named as a ranked individual in both Chambers and Legal 500.

"Christopher Fanner is a name to rate" and he is noted for his "eagerness to get involved with innovative and unprecedented transactions" (Chambers UK).

Marketing private funds in the Middle East

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As private fund managers increasingly look to the Middle East for new sources of capital, many are having to grapple with a new regulatory environment, and the United Arab Emirates' new investment fund regulations have been posing some challenges. But fortunately, as the new rules have started to operate in practice, navigating them is becoming a little more straightforward.

The UAE is home to a number of important investors, so its rules matter, and the new regime creates an immediate obstacle: it requires that those seeking to promote foreign funds in the UAE may only do so by engaging a locally licensed promoter. That local promoter must obtain the prior approval of the UAE's regulator, the Securities and Commodities Authority (SCA), to market the fund. There is an exemption from the requirement to use a local promoter if the fund is to be marketed to institutional investors each investing a minimum of 10 million dirhams (€2.1 million), but only if the marketing is undertaken by a local representative office of the foreign fund manager.

The UAE's rules do not include any form of private placement exemption, and some fund managers had questioned the costs of contracting with a local promoter, and obtaining prior SCA approval to market the fund, without any guarantee of investor interest. Similarly, some local investors had raised concerns that the strict licensing requirements could result in fewer investment opportunities being available to them. Perhaps in response to that feedback, the SCA recently organised a public meeting to discuss the rules. At that meeting, senior staff of the SCA, who had themselves been involved in drafting the rules, gave their interpretation of some of the key provisions.

These interpretations were very helpful. In particular, the SCA said that the regulations were not intended to catch the practice of "reverse solicitation" based on previous dealings or a pre-existing relationship with an investor, including where the relationship was formed before the new rules came into force. Whilst the rules are silent on reverse solicitation, it had been commonly assumed – based on discussions with the SCA, and parallels with other local regimes – that such practices were caught.

This interpretation means that – if foreign fund managers have a pre-existing relationship with UAE investors, and those investors have expressed an interest in the funds of that fund manager – those funds may now be marketed to those investors in the UAE without the need for the overseas fund manager to engage a local promoter or to obtain the prior approval of the SCA. The reverse solicitation exemption applies to both institutional and retail investors. Whilst SCA staff did not stipulate that the fund manager would be required to maintain documentary records, it is clearly advisable to do so. The SCA re-iterated that its rules are designed to catch the practice of cold calling, whether to institutional or retail investors, and the local licensing requirements apply to investors with whom the manager has no previous relationship.

Also useful was the statement that, although the SCA is required by the rules to give its decision within 30 business days of receiving an application for approval, in practice the approval process is currently only taking a few days. In addition, whilst there is in theory a fee to be paid to the SCA when applying for approval, the fee schedule has not yet been published and the SCA has not yet sought to charge fees.

Another welcome interpretation will assist those who choose to market through a representative office: the SCA confirmed that a representative office of a placement agent would be enough. It remains to be seen whether placement agents seeking to place funds in the UAE – in circumstances where the reverse solicitation exemption does not apply – will create a local presence (which requires a licence from the Department of Economic Development), or will engage locally licensed promoters to undertake the marketing on their behalf.

Whilst this is all good news, some continuing caution is advisable. These interpretations are not binding on the SCA, and may not be entirely consistent with the letter of the law. However, it seems likely that the SCA will stand by comments made by its staff unless and until it makes an announcement to the contrary.

Zero tolerance: UK adopts an even harder line on bribery

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Anyone who does business in the UK, or has a connection to it, should be aware of the relatively new (and well publicised) rules on bribery and corruption. Private equity fund managers have analysed how the rules apply to the non-executives that they put on the boards of their portfolio companies, and to what extent they might be held liable for breaches in their portfolio companies. They have also established or updated policies for themselves and their portfolios, and are paying close attention to pregnant liabilities during due diligence. With the significant financial and reputational consequences that can follow from a prosecution under the wide-ranging UK bribery laws, no firm should be complacent about the risks.

Recent announcements by the UK's main prosecuting authority for bribery offences – the Serious Fraud Office (SFO) – have brought the British regime back into the spotlight, and these announcements adopt a more hard line approach than business had been led to expect by the SFO when the law first came into force.

For instance, the SFO's restated approach to "facilitation payments" – which are payments made to government officials to speed up a particular action or transaction, or to ensure that it takes place – states that all forms of such payment, however small or infrequent, may lead to prosecution. Although the law makes it clear that all facilitation payments are unlawful, the previous Director of the SFO, Richard Alderman, took the view that the SFO would not prosecute businesses which continued to make facilitation payments overseas, in breach of the Act, provided that they were working towards phasing out such payments. Mr Alderman's preferred approach was "to see people working towards zero tolerance of facilitation payments over a period of time". It was generally understood, therefore, that the SFO would not prosecute cases of "small" facilitation payments provided that commercial organisations were taking steps to reduce and prevent the making of such payments.

The SFO's new position is much more robust. The new policy states, unequivocally, that facilitation payments "were illegal before the Bribery Act came into force and they are illegal under the Bribery Act, regardless of their size or frequency".

The implications for private equity firms which invest in those parts of the world where such payments are commonplace are, therefore, potentially very significant. It is likely that they will need to review their compliance policies yet again to ensure that they do not fall foul of the SFO's new approach.

In another change of direction, the SFO has also modified its approach to corporate self-reporting. Previously it sought to encourage commercial organisations to self-report cases of bribery and corruption by offering reassurance that they would face civil penalties, rather than criminal prosecution. For example, the SFO's statement of its "Approach… to dealing with overseas corruption", dated 21 July 2009, stated that "the benefit [of self-reporting] to the corporate will be the prospect (in appropriate cases) of a civil rather than a criminal outcome as well as the opportunity to manage…any publicity".

That reassurance has now been withdrawn. The SFO's new policy is very clear that if companies decide to self-report, there is "no guarantee that a prosecution will not follow" and "each case will turn on its own facts". Needless to say, this lack of certainty will be of significant concern to any commercial organisation when faced with the question of whether to self-report instances of bribery or corruption.

The message from the SFO is that these changes are intended to provide helpful clarity. However, it seems that the new Director of the SFO, David Green QC, is signalling his intention to take a more aggressive, prosecutorial approach to cases of bribery and corruption.

Whether the SFO will have the necessary teeth to back up its new approach remains to be seen, but the change of attitude could in fact dissuade companies from self-reporting in circumstances where they are unsure as to the SFO's approach and lead to fewer, not more, instances of bribery and corruption coming to the SFO's attention. In any event, private equity firms should take this timely reminder that the UK's laws on bribery and corruption are now amongst the toughest in the world, and the prosecutors are keen to give the law sharp teeth to match.

Emerging Trends in Regulating the Upstream Oil and Mining Sectors in Kenya

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Introduction

The discovery of oil and gas in Kenya as well as the improving profile of Kenya's mining sector has brought fresh focus of these sectors in the country. The changes have resulted in renewed investor-interest in the mining and the up-stream oil sector as well as the Government's resolve to tighten regulation of the sector and impose restrictions aimed at ensuring maximum returns for Kenya and its citizenry from the resources.

Oil Exploration and Regulation

2012 marks the year Kenya struck oil after decades of exploration. With oil drilling continuing in northern Kenya and in other parts of the country, the Government is keen to rid the industry of vices that may spark its regressive growth.

The main legislation pertaining to Oil exploitation and exploration in Kenya are the Kenyan Constitution, 2010 and The Petroleum (Exploration & Production) Act (Cap. 308) (PEPA).

Kenya has adopted the "Production Sharing Product model" on exploration. This model involves private players taking the risk in oil exploration in return for reward through rights to extract and produce oil if commercially viable deposits are discovered. Under PEPA, the Minister acts on behalf of the Government to regulate Production Sharing Contracts (PSC's). The Minister has a duty to, *inter alia*, negotiate, enter into and sign petroleum agreements on behalf of the Government.

The 2010 Constitution requires Parliament enact legislation on natural resources. This would result in an overhaul of PEPA, a 1986 statute which is considered to be out-of-date. In addition, the Constitution requires Parliament to ratify agreements involving the grant of a right or concession to another person for the exploitation of any natural resources of Kenya. Natural resources under the Constitution include among others, minerals, fossil fuels and other sources of energy (which would include oil and gas resources).

The legislation regarding natural resources agreements is yet to be enacted but plans to enact the new legislation are currently underway. Stakeholders in the oil exploration industry are keen to see the outcome of the natural resources legislation and the impact it will have on the sector.

An investor intending to consummate an acquisition of a substantial interest under a PSC that may result in a change of control is required to seek the consent of the Competition Authority under The Competition Act prior to completion of the transaction. Failure to obtain consent renders the transaction void. In addition, the PSC may either require the Minister to be notified of the change of control or the consent of the Minister to be obtained in respect of the change of control – this depends on the drafting of the particular PSC.

Tax on transfer of exploration blocks

The Government has also proposed the introduction of capital gains tax on the gains made upon farming out of participating interests in PSCs as well as gains made on the change of control of a company holding a PSC.

The Finance Act, 2012 intends to amend the underlying statute – The Income Tax Act, to introduce capital gains tax on the "*…the sale of property or shares in respect of oil companies, mining companies or mineral prospecting companies*". The applicable withholding tax rates are 20% and 10% of the gross amount payable on payments to non-resident and resident persons respectively.

It is not clear whether the Government intends to apply this new tax retrospectively. Recently, the Government has withheld its consent on the sale of interests in oil exploration blocks as it works out a model for levying and collecting capital gains tax on such transactions.

Mining and its Regulation

Kenya has in the last few years discovered economically viable quantities of gold deposits, titanium, iron-ore and coal and is reportedly likely to be sitting on vast quantities of buried wealth.

Prospecting rights, exploration licences and mining leases are issued by the Commissioner of Mines under the Mining Act. A prospecting right enables the holder to identify potential areas with mineral resources. Exploration licences enables the licensee to undertake in-depth analysis of a specific area to identify locations with minerals resources that

can sustain profitable mining. Mining leases on the other hand vests the holders with rights to mine specific minerals in the area covered by the lease within a specified period.

Until September, 2012, there had been no restriction on the ownership of mining rights and licences. The Mining Regulations, 2012 however introduced a new requirement that it shall be a condition of every mining licence that the mineral right in respect of which the licence is issued shall have a component of local equity participation amounting to at least 35% of the mineral right. It is unclear how the equity participation requirement will be implemented by the Government and stakeholders in mining are on the lookout for this.

The Mining Act also has certain shortcomings. For example, the definition of what is a "mineral" under the Act is limited. Limestone for instance is not a mineral under the Act.

It is against this backdrop that the Minister of Environment and Natural Resources proposed the Mining Bill, 2012 which seeks to repeal and overhaul the Mining Act.

The Mining Bill, 2012

The draft Bill intends to classify minerals into six main groups. These are: the construction and industrial minerals group e.g limestone, soda-ash and sand; the precious stones group e.g diamonds; the precious metal group e.g gold and silver; the semi-precious stones group e.g quartz; the base and rare metal group e.g aluminium; and the fuel metal group e.g coal and uranium

The draft Bill seeks to categorise licences into two main categories: large scale and small scale mining. Small scale operators will be granted prospecting and mining permits. Only Kenyan citizens or a body corporate composed of Kenyan citizens will be eligible to obtain small-scale permits.

Foreign ownership of large scale licences is not restricted under the Bill. Similarly, there are no mandatory local equity participation requirements in the draft Bill as in the Mining Regulations 2012. Moreover, unlike under the Mining Act, prospecting rights under the draft Bill will be granted directly to a company.

It is hoped that the draft Bill will upon its enactment streamline issuance of mining licences and facilitate efficient and expeditious growth of the mining sector. The draft Bill has been approved by Cabinet and is to be presented in Parliament for debate.

Other Government intervention in mineral and oil exploration

Government bodies and departments have also been taking various steps in the mining and oil exploration sector which impact the sector in various ways. For instance:

- The Ministry of Energy in conjunction with third parties organized the East Africa Oil & Gas Summit, 2012 in Kenya. The government sought to market East Africa, and in particular Kenya, as the leading international hub for trade and investment in the rapidly expanding east Africa oil and gas market.

- The Ministry of Energy proactively enacts rules and regulations to help oil and gas companies to navigate through the challenging regulatory environment. To date, 10 regulations have been enacted and 10 draft regulations are in the offing.

- The Kenya Forest Service in its quest to conserve forests has introduced a range of fees targeting, among others, mining companies and power distributors in the country.

- The Ministry of Energy has suspended the "first-come first-served" basis of issuing exploration licences. This is because the policy had resulted in infiltration of the sector by cartels which obtained exploration permits for speculation purpose and lacked capacity to undertake oil search, their main aim being to offload their licences to foreign investors.

Conclusion

To achieve sustainable use of oil and mineral resources, structured distribution of drilling rights and mining blocks is imperative. The legislative challenges notwithstanding, the Government seeks to maximize opportunities to improve the livelihoods of Kenyans and avert mineral and oil resources turmoil experienced in other countries.

Milestones the Government seeks to overcome include establishing a regulatory body that fosters transparency in contract negotiations, balancing oil exploration and production with conservation of unique biodiversity, enforcing high standards of corporate responsibility and regulating land sales to prevent conflicts as well as balancing the investor and other stakeholders' interests to ensure availability of the capital and resources required for oil and mining exploitation.

SJ Berwin gives a helping hand in Kenya

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Give a Dam

In 2010 SJ Berwin's Charity of the Year was Excellent Development (ED), a UK-based organisation that works to bring sustainable water supplies to vulnerable communities across the rural drylands of Kenya. The simple yet miraculous technology at ED's disposal is the sand dam - a reinforced concrete wall built across a dry sandy river which, when struck by seasonal rains, causes moisture-laden sand to accumulate behind it. Up to 40% by volume of the resultant 'sand reservoir' is actually water and because the water stored within the sand can be accessed by pipe or well, it is protected from both evaporation and malarial infestation. Moreover, sand dams are the world's lowest cost method of capturing rainwater in dryland regions, providing a clean water supply for up to 1,000 people for life.

ED operates in close partnership with the African Sand Dam Foundation (ASDF), a Kenyan NGO, and together they share a long-term vision to advocate and proliferate sand dams throughout the dryland regions of the developing world. The strength of ED's model rests upon the following premises:

- **self-help** - community groups must demonstrate sustained, effective intra-group collaboration and resource management before being granted a sand dam;
- **long-term benefits** - sand dams not only improve water supplies and (through irrigation) food production but, with continuing support from ASDF, also create a virtuous cycle resulting in self-sufficiency, better education for children and ultimately, poverty alleviation;
- **crisis mitigation** - sand dams preserve soil and water, giving communities security against future drought and climate change; and
- **proliferation** - ED operates an open-book policy, encouraging larger NGOs and foreign governments to replicate the sand dam model.

Volunteers and workers building the dam project

In September 2012, building on SJ Berwin's existing relationship with ED, I was able to visit a number of the seven communities that SJ Berwin and its volunteer team had previously helped and to witness the communities' gratitude for the impact that sand dams have since had on their lives.

Having undertaken further fundraising in the UK, I also worked alongside the Wendano wa Kithyululu Self Help Group and other volunteers to construct a new sand dam. In October the rains came, giving those who stand to benefit a strong foundation to build upon.

For further details of Excellent Development's transformative work, please visit: www.excellentdevelopment.com

Recognition for SJ Berwin's involvement in the project

Some of the many beneficiaries of the project

Have the miners' strikes left the South African mining industry on shaky ground?

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The mining sector has played a pivotal role in the industrial development in South Africa. However, this has been overshadowed in 2012 by the strikes at Lonmin's Marikana mine and elsewhere (including the tragic death toll and injuries), which have brought underlying unrest and tension within the mining sector in South Africa to a head. The miners participated in strikes to secure a national living wage and it has been estimated that over 75,000 miners were involved.

The miners' strikes had a significant impact on production in South Africa, which has in turn led to a reduction in the value of the Rand, a downgrade of South Africa's sovereign debt rating and the valuation of companies listed on the JSE and the mining sector generally. According to President Jacob Zuma, the strikes cost South Africa in excess of £300 million.

The strikes have also highlighted the miners' living conditions and indeed the Government's failure to force the mining companies to comply with the mining laws which link the mining licences to the rights and the social conditions of the miners. Concerns have also been raised by mining companies failing to comply with safety requirements. This is particularly important because South Africa's gold mines are getting deeper and therefore more expensive and indeed dangerous to mine.

Despite all the above, the country still has one of the most promising economies in the world in terms of growth potential. This article explores the impact of the miners' strikes and whether making improvements to legislation and regulation of the mining sector in South Africa could provide the necessary impetus to further promote the sector.

Impact of the strikes on the South African economy

The uncertainly caused by the strikes led to foreign investors rethinking their investments against the backdrop of an economy which has already shown signs of slowing down, Together with policy uncertainty due to the election which took place in December 2012, of the leaders of the ruling ANC party, which retained President Jacob Zuma as leader and elected a leading ANC stalwart and businessman in Cyril Ramaphosa, as deputy, the impact on the sector was wide-ranging.

However, this election result ultimately went some way to appeasing those who thought that South Africa lacked the political will, resources or the infrastructure to resolve the deeply entrenched social, political and economic issues, although this remains to be seen. Most importantly, the ANC confirmed that nationalisation in South Africa, including the mining sector, was off the agenda. This was a key concern. Cyril Ramaphosa recently described the strikes as a "wake up call" for the mining sector and business and called for all parties to become more "inclusive" in their actions, which has been seen as a positive step forward.

Notwithstanding, the impact of the strikes have been onerous on mining. London listed company Lonmin, was forced to replace its CEO and it recently completed its $817 million and fully underwritten rights issue to pay down debt and de-risk its balance sheet to prevent the company from breaching covenants in March 2013. It repaid in full its existing US$700million bank facilities and entered into a new US$400million revolving credit facility. It also struck a pay deal with its miners, which sets a precedent at a time when the mining industry is struggling with rising costs.

Lonmin has admitted to a number of failures including having poor relations with employees and has even admitted that these issues could have contributed to the strike action. Lonmin's licence to mine in South Africa is potentially at risk and the company's future in South Africa will depend on whether Susan Shanangu, the Mineral Resources Minister, decides to take action. Although on 23 January 2012, President Jacob Zuma announced that the South African government need to engage with platinum and gold mining firms about proposed shaft closures and mass redundancies and is not threatening them with licence reviews.

The impact of the strikes also indirectly claimed the scalp of Anglo American's CEO, Cynthia Carroll, who will be replaced by Mark Cutifani in April 2013 and its 80% subsidiary, Anglo American Platinum, recently announced an overhaul of its structure, including the closure of two mines and the shedding of 14,000 jobs in South Africa in the wake of the crisis.

AngloGold Ashanti, the world's third largest gold producer suspending its entire South African operations after 24,000 of its 35,000 workforce went on strike.

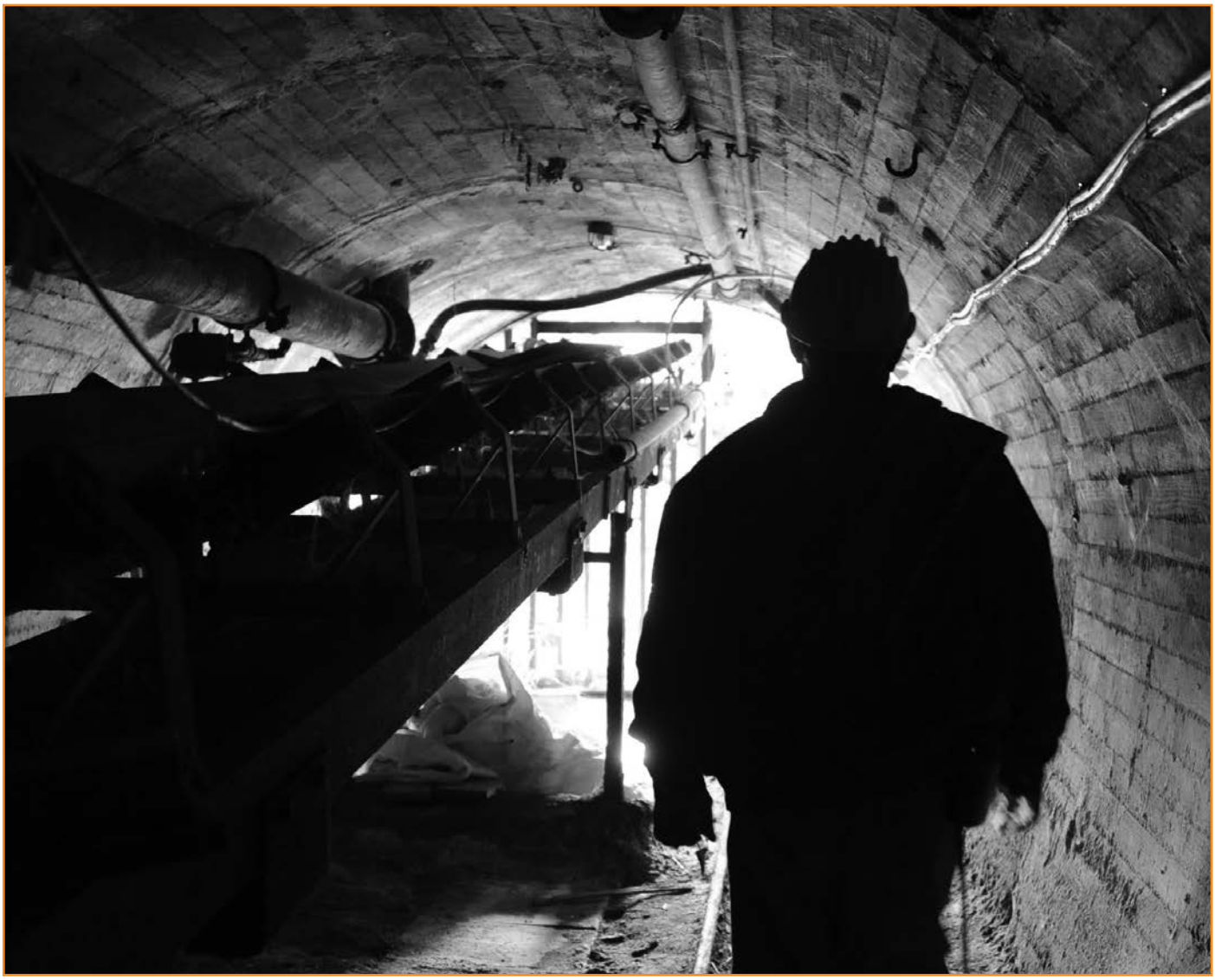
Impact of the miners' strikes on current legislation

Unemployment is the most serious threat to social cohesion in South Africa today and South Africa's labour friendly laws could be the cause of the high unemployment rate and the reluctance of overseas investors to invest. However, under South Africa's industrial relations legislation, pay strikes by miners is "unprotected", so there is no immunity from disciplinary action provided by "protected" strikes called by unions with bargaining rights.

The National Prosecuting Authority used obscure apartheid legislation to hold miners responsible for the deaths of the miners who were killed during the mining strikes. Clearly the law needs to be updated in this respect. There are also concerns that South Africa's policy making is too far removed from the economic reality.

The current labour laws are too onerous and a balance needs to be struck. As Humphrey Borkum, chairman of the JSE explained, labour legislation needs to be changed because at present it almost encourages conflict between the unions. Labour legislation needs to be amended so that the mining company can be formally directed to sit around a table and talk to all unions at the mine and not only the one that is recognised with over 50 per cent of the workers.

By way of comparison, in the UK today, employees have the right to take industrial action, however, under the common law it is unlawful to induce people to break a contract or to interfere with the performance of a contract, or to threaten to do either of these things. Consequently, trade unions or trade union officials would face the possibility of legal action being taken against them



for inducing breaches of contract every time they called a strike.

"Statutory immunities" were introduced into legislation so that in certain circumstances, industrial action can be organised without fear of being sued in the courts, for example, where there is a trade dispute, and the action is called in contemplation or furtherance of that dispute. The available immunities are subject to a number of restrictions, so as to provide an effective remedy against some of the most damaging and disruptive industrial action. It is also a condition of immunity that before calling a strike or other industrial action a trade union must first obtain the support of its members through a properly conducted ballot giving appropriate notice and others.

Some will recall that the UK miners' strike ended in 1985 with the miners' defeat and the Thatcher government able to consolidate its fiscally conservative programme. Consequently, the political power of the National Union of Mineworkers was broken permanently and was viewed as a major political victory for Margaret Thatcher. It is unlikely that such drastic steps will be undertaken in South Africa to materially alter the landscape and shift the balance of power between unions and the mines.

President Jacob Zuma recently announced that there will be a Judicial Commission of Inquiry into the Marikana tragedy. Lonmin has welcomed this announcement and confirmed that the company will co-operate fully with the Commission. The Commission will, amongst other things, examine Lonmin's policies generally, including the procedure, practices and conduct relating to its employees and organised labour.

Calls for changes to the Regulation of the Mining Sector

South Africa's mining sector is governed by the Mineral Petroleum Resources Development Act, No.28 of 2002 (the "Act"). Some commentators have blamed the miners' strikes on the Act and the Mining Charter which have not been successful in transforming the ownership and control of the mining sector and the conditions for miners. The Mining Charter was reviewed recently in 2010, although this did not lead to any radical changes and failed to address housing and living standards around the mines.

During the Cabinet meeting on 5 November 2012, the Cabinet approved the submission of the Draft Mineral and Petroleum Resources Development Amendment Bill 2012 to Parliament which was published on 27 December 2012 for consultation by 8 February 2013.

BEE Compliance in the mining sector

One of the purposes of the Act was to transfer 26% of the ownership of South Africa's mining industry by 2014 to meet black economic empowerment ("BEE") objectives. The BEE code was established by the South African Government to address the inequalities of the Apartheid past by giving historically disadvantaged South Africans economic opportunities that were not previously available to them. However, the trade unions do not think that the mining industry is making sufficient efforts to meet those targets. The recent turmoil in South Africa has provided the impetus for the state to push through more aggressive BEE policies.

A revised version of the BEE code was announced on 2 October 2012 and according to Trade and Industry Minister, Rob Davies it aims to broaden the empowerment base and ensure that genuine empowerment takes place. However, there is concern that this will have the opposite effect. There is also a backlog of approximately 2,000 unresolved appeals or reviews of administrative decisions under the Act.

James Motlatsi, who started as a labourer in the mines and later became founding president of the National Union of Mineworkers and former deputy chairman of AngloGold is of the view that the whole mining industry needs to be restructured. BEE compliance is expensive for companies, which also have to spend vast amounts of money on workers and communities to fulfil their obligations under the Mining Charter. James Lorimer, the Democratic Alliance's shadow minister of mineral resources recently said that "Absolutely BEE in mining has failed. It has been a disincentive to investment while providing no benefit to the majority of South Africans".

Conclusion

Prior to the recent strikes and unrest in South Africa, positive steps were being taken on transformation as the mining sector has the ability to provide the wealth for South Africa to develop into the continent's largest and most advanced economy. However, stakeholders are now under significant pressure to provide certainty for investors and to address the inequalities and injustices to assist with the reduction of poverty, improvement of working conditions and easing of unemployment in society. To achieve this clear focus is required by the mining houses, unions, miners, government, regulation and society as a whole.

Ultimately, South Africa will need to dig deeper to prevent future strikes and to restore investor confidence, in a similar fashion to the successful way in which the Thatcher government ended the miners' strikes in the UK in 1985, although times have moved on and the complexities of the sector in South Africa and the deep social, political and economic issues are vastly different.

ILFA Update - 2012 Review and Awards Dinner

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International Lawyers for Africa – (ILFA) 2012 came to a spectacular conclusion with the annual gala dinner hosted by the President of the Law Society. The keynote speaker was Madam Fatou Bensouda - Chief Prosecutor of the International Criminal Court. The event was attended by almost 200 guests some of whom had flown in from Africa specifically for the dinner. Such is ILFA's growing reputation.

The dinner heralded the end of ILFA's sixth secondment programme. Which this year hosted 19 African lawyers from Botswana, Ghana, Kenya, Nigeria, Malawi, Rwanda, South Africa, Tanzania, Tunisia, Uganda, Zambia and new ILFA participant Senegal.

With a strong alumni of close to 100 lawyers across Africa – ILFA has established itself both in the UK and Africa. ILFA hopes to strengthen and galvanise support in Africa with a view to recreating the ILFA experience and giving value on African soil. Ideas that are under consideration are:

- Utilising social media and ICT to reach out to more African lawyers
- We also hope to put in place a mentoring programme in Africa utilising the alumni.
- Cross regional secondments within Africa - a natural progression of the cross border network, Expanding the programme to other jurisdictions.

Launched in 2006 ILFA is an multi awarding winning CSR initiative. SJ Berwin was instrumental in setting up ILFA and continues to facilitate its administration which now involves 17 jurisdictions. The Financial Times recognised our achievement with ILFA by presenting us with the Financial Times Innovative Lawyers Award 2008 and The Lawyer publication awarded us the Pro Bono Firm of the Year Award in 2008.

ILFA aims to build legal capacity in Africa by helping to equip African lawyers with additional legal skills and expertise in key areas of public international law, corporate law, international dispute resolution and key legal practice skills. The programme enables international law firms to contribute to the development of African lawyers, by providing three months of high quality training and work experience.

The participating lawyers in 2012 were a mix of in house legal counsel, Government counsel and private practitioners. Competition for places on the programme is very stiff and some ILFA countries such as Cameron, Sierra Leone, Namibia, Zimbabwe and Sudan we unable to secure a place this time round. The competition is set to intensify next year with possible participation of Angola and Mozambique.

In 2012, SJ Berwin in conjunction with HJ Heinz Limited hosted two lawyers on the programme; in-house counsel from Airtel in Malawi, Hlupi Phiri and a lawyer from the Development Bank of South Africa, Deon Nel.

David Parkes (Co-head of Africa Group, SJ Berwin) and Olufemi Lijadu (Partner, Ajumogobia & Okeke, Nigeria)

Chanda Musonda (ILFA Zambia), Masu'd Balogun (ILFA Nigeria) and Mandidpa Machacha (ILFA Botswana)

Anna Gardner (ILFA director), Fatou Bom Bensouda (Chief Prosecutor of ICC) and Toyin Ojo (ILFA co-ordinator, SJ Berwin)

Zimbabwe Investment Luncheon hosted by SJ Berwin

On 26 November 2012, SJ Berwin, in conjunction with Peregrine Media Group and DEAT Capital, hosted a Zimbabwe Investment luncheon at its London offices. The Conference outlined the investment opportunities available to UK and international companies and the key speaker was the Hon. Taipwa Mashakada, Minister of Economic Planning and Investment Promotion for the Republic of Zimbabwe.

The event was also attended by Cecil Chinenere, acting Zimbabwe ambassador to the UK, Dr Desire Mutize Sibanda, Permanent Secretary in the Ministry of Economic Planning, Nicky Moyo, an investment advisor in the Ministry, Donald Charumbira from the Zimbabwean Embassy in London and clients and contacts of the firm.

The Minister emphasised the investment opportunities available in Zimbabwe and the competitive advantages of investing in the country. He also highlighted the Zimbabwe Government's efforts to encourage foreign direct investment in the country and increase their ranking in the ease of business index with innovative solutions such as the "one-stop-shop" for foreign investors. Zimbabwe's indigenisation legislation was also addressed with the Minister stating the Government's flexibility in determining the level of foreign non-indigenous equity ownership based on factors such as the extent to which foreign investors are localised in Zimbabwe and contributing socially.

An example given was the proposed auction of the State owned Zimbabwe airlines which is being sold on the basis that the State will retain a 26% holding, which is in contrast to the indigenisation legislation that promotes a 51% local ownership.

The Minister (centre), his Permanent Secretary and representatives from the Zimbabwean Embassy, Nicky Moyo with David Parkes (Co-Head of the Africa Group) and Barri Mendelsohn of SJ Berwin

Challenges facing Zimbabwe were raised including issues with liquidity and the country's trade imbalance. A number of other issues were explored such as Zimbabwe's position as one of the fastest growing economies in southern Africa, the country's vast natural resources and agriculture sector, the Government's efforts to promote foreign direct investment and the launch of another Diaspora bond.

The Minister agreed that many investors were waiting on the outcome of the 2013 elections which are widely hoped to be free and fair in order to kick-start investment in the country.

Investment Roads Opening Up In Zimbabwe: A Brief Overview

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Introduction

Zimbabwe's economy is just starting to recover from over a decade of hyperinflation and a massive economic recession. The relative stabilisation of Zimbabwe's economy since hyperinflation has resulted in increased investor confidence. In the midst of its recovery, an international investment research group survey has ranked Zimbabwe as one of the top three African countries which offer the best investment return between now and 2016.[1] Currently Zimbabwe has an inflation rate of 3.5% one of the lowest inflation rates in Africa. Its economy is fast growing; its GDP growth at present parallels the BRIC economies. Zimbabwe's GDP grew by 9.6% in 2010, 10.6% in 2012 and 4.4 % in 2012.[2] Deals are being done, investor money is trickling in, but the oft asked question is why and how given the perceived chaos of the recently past years?

Zimbabwe has a highly skilled labour force and is well endowed with vast mineral, agricultural and tourism resources. Aggressive investors who are keen on investing in Zimbabwe should familiarise themselves with the business environment and the legal requirements of investing in Zimbabwe and also devise ways to manage and secure their investment. Most importantly investors should identify good local counsel to 'handhold' them through the process of investing in the Zimbabwean market.

Zimbabwe Investment Authority (ZIA) License

In respect of foreign direct investment into Zimbabwe, the most crucial aspect is obtaining a seal of approval from the Zimbabwe Investment Authority in the form of an investment license. The license assists in attaining a certain measure of investment certainty and security against pitfalls that an investor might fall prey to when operating informally or 'under the radar.' For purposes of repatriation of income, taxation and export and exchange controls and import tariff dispensations, it is highly recommended that any foreign investor obtain this approval and be in possession of a valid investor license.

With the recent introduction of ZIA's 'One-Stop Shop', all processing of investment has been streamlined into one central department where all the relevant regulatory bodies are housed. This includes the Ministry of Youth Development, The Ministry of Indigenization and Empowerment, the Registrar of Companies, Zimbabwe Revenue Authority and Ministry of Mines and Mining Development to name a few. This has helped tremendously in curtailing bottleneck and bureaucracy delays that were an unfortunate characteristic of ZIA in the past, i.e. it now takes between 5-10 days for approval of an investor license once all relevant papers have been submitted.

According to reports, in 2011 alone, ZIA approved projects were close to US$6 billion, but this has waned over the course of 2012. This could be attributed to potential investors' hesitancy in

the feasibility of doing business in Zimbabwe's current political climate. Another factor is also the difficulty in implementing the projects once approved, and this is especially true for the highly regularized sectors like mining and manufacturing, as well as difficulty in raising capital. In a recent interview with the Herald Business, a local paper, ZIA's Chief Executive Officer has attributed this to the negative perceptions of Zimbabwe being a risky place to do business. However, although these approval figures do not necessarily become translatable into real foreign direct investment, they could be indicative of foreign interest in the country by investors as well as the crucial role played by the ZIA in shaping the investment landscape of the country. Over and above this, it suffices to say that given the measures and procedures put in place by ZIA, Zimbabwe remains one of the premier investment locations in the region, and with the aid of a well-structured investment plan; it could prove to be very rewarding.

Indigenisation

The realisation of the investment potential in Zimbabwe has coincided with the promulgation of indigenisation laws in Zimbabwe and the restrictive measures/sanctions placed on Zimbabwe, which measures are making it more difficult for UK, EU, Canadian and United States companies to freely contract with certain Zimbabweans and entities, especially in the public sector. Foreign investors thus must have an appreciation of indigenisation laws when considering investing in Zimbabwe and understanding of potential conflict with restrictive laws targeting Zimbabwe in their own home countries.

The purpose of Indigenisation is to deliberately involve indigenous Zimbabweans in the economic activities of the country in order to ensure the equitable ownership of the nation's resources. Section 2 of the Indigenisation and Economic Empowerment Act [Chapter 14:33] defines an indigenous Zimbabwean as "any person who, before 18 April 1980, was disadvantaged by unfair discrimination on the grounds of his or her race, and any descendants of such a person and includes any company, association, syndicate or partnership of which indigenous Zimbabweans form the majority of the members or hold the controlling interest". A foreign investor wishing to conduct business ventures in Zimbabwe would be required to partner with an indigenous Zimbabwean, in such a manner that would see the indigenous Zimbabwean with an ideal shareholding of 51% and the foreign investor with 49% shareholding. This is encompassed in section 3 (1) (a) of the Act, which provides that the Government shall endeavour to secure that at least fifty-one per centum of the shares of every public company and any other business shall be owned by indigenous Zimbabweans.

So how is indigenization compliance achieved?

From the onset, a thorough due diligence exercise must be carried out on the prospective indigenous business partner. Apart from setting up the requisite business vehicle, the foreign investor and the indigenous partner (the parties) must agree on the structure of the management contract which is drawn up to regulate the relationship between the parties as shareholders in the business venture, regard being had to the working capital and equity to be contributed by the investor. Indigenization does not negate the need for any deal to be done on strict commercial terms and the regulations do not in any way advocate a 'free equity ride' for the empowerment partner/s. All standard forms of financing can be used in this process to achieve real business with real financial obligations notwithstanding the empowerment requirement/ideal. The management contract should also reflect the involvement of indigenous Zimbabweans in key positions in the business venture. In line with Section 4 of the Indigenisation and Economic Empowerment Act [Chapter 14:33], approval must be sought from the Minister for the intended indigenisation and empowerment arrangement. The Minister's decision to approve or reject the application is largely based on whether he is satisfied that the indigenous Zimbabwean is, indeed, in possession of the controlling interest. It is therefore important to ensure that the shareholding agreement depicts a more realistic share structure in the business venture rather than what has been put in place merely for compliance purposes. It is criminal in terms of the law to create 'fronting structures' so caution regarding this must prevail.

Exchange Control Regulation

Foreign Investors also have to take cognisance of exchange regulations in Zimbabwe. Zimbabwe has adopted a liberal exchange control environment since 2009 where most authorization has been passed to commercial banks with supervision and monitoring carried out by the Reserve Bank of Zimbabwe. Due cognizance has been taken in the exchange control regulatory framework to ensure that Zimbabwe remains a conducive market that fosters the free and unfettered mobility of local and foreign capital. There are however inflow restrictions above specific thresholds where regulatory approval must be sought. This is both for loans and equity contribution.

The capital account (the account that reflects the net change in national ownership of assets) has been partially liberalized in Zimbabwe. Applications pertaining to the receipt or payment of capital transfers and/or acquisition/

disposal of non-financial assets and liabilities of the country must form the basis of specific applications to the Exchange Control Review Committee. The requirement for vetting of capital account transactions is necessary to ensure that the country is cushioned against global economic and financial shocks which have a bearing on foreign private capital flows, such as to protect the country against capital flight. While these requirements have been put in place, due cognizance has been taken of ensuring that Zimbabwe remains a conducive market that fosters the free and unfettered mobility of local and foreign capital.

Specific applications to exchange control will be needed for investment in listed and unlisted companies, investment proposals, dilution proposals, mergers and takeovers, dual listing of shares and restructuring and rights issue of shares. With disinvestment, investors may only remit the initial capital outlay plus appreciation after exchange control approval has been granted.

With investment in listed companies, the investment proceeds qualify for 100% remittability rights subject to deduction of the relevant withholding tax. Any amounts arising from capital appreciation and capital gains made on disposal of such investments will be freely remittable subject to the deduction of capital gains tax.[3]

Taxation In Zimbabwe

Any proposed investment into Zimbabwe will, at some point, attract tax liability for the investor investing in Zimbabwe; whether in the form of withholding tax, taxation on dividends declared by a company owned by the investor, or capital gains tax where the investor disposes of a specified asset. However, there are ways in which tax efficiency can be improved for potential investors, particularly through the use of tax deductions provided by Double-Taxation Agreements ("DTAs") between Zimbabwe and particular countries. This section will thus detail the taxes typically paid by investors in Zimbabwe, as well as providing information on how investors can make DTAs work in their favour. These DTA's allow for tax efficiency on any investment in Zimbabwe because of the fact that any income derived from an investment which is subject to a DTA will allow the investor receiving that income to pay a lower rate of tax by virtue of the DTA. Zimbabwe has entered into comprehensive DTA's for the avoidance of double taxation on the same income with the following countries: Botswana, Bulgaria, Canada, France, Germany, Malaysia, Mauritius, Namibia, Netherlands, Norway, Poland, South Africa, Sweden and the United Kingdom.

Zimbabwe also has pending DTA's with China, Indonesia, Namibia, Singapore, the Seychelles, Switzerland, Tanzania, Thailand, Tunisia, Yugoslavia, Zambia, the Democratic Republic of Congo and South Africa (renegotiation).

Section 93 of the Income Tax Act[4] deals with situations where no DTA exists between Zimbabwe and a particular country. Section 93 provides that tax chargeable in Zimbabwe will be reduced by the amount of foreign tax paid or payable on any income derived by a person if that person proves to the satisfaction of ZIMRA that he has paid tax on the same income in a foreign country where the income was derived. However, Section 93 is only applicable where that person is deemed to have derived income from a source within Zimbabwe, but this person is liable to pay, or has paid, tax for any year on income which is derived from a country which does not have a DTA with Zimbabwe.[5]

Withholding Tax in Zimbabwe

In terms of Section 80 of the Income Tax Act (Chapter: 23:06), a 10% withholding tax is deductible from all amounts payable to all persons who enter into contracts with the State or a statutory body, a quasi-government institution and taxpayers who are registered with the Zimbabwe Revenue Authority ("ZIMRA"). Unless a payee furnishes the paying officer with a tax clearance certificate, any person who enters into a contract (whether for goods or services) worth US$ 250.00 or more involving a single transaction or multiple transactions should deduct the withholding tax.

Capital Gains Tax

Capital Gains Tax ("CGT") is of fundamental importance when dealing with Zimbabwe's tax landscape, particularly in the context of investments into Zimbabwe. Investments, whether in the form of the purchase of securities or the purchase of immovable property, will typically involve the levying of CGT where a specified asset is disposed of by or to an investor.[6] CGT is calculated at a rate of 20% of the capital gain. The rate of capital gains withholding tax for unlisted securities was reduced from 10% to 5% with effect from 1st September 2010. In the case of a sale of a listed marketable security (e.g. listed shares), the rate of Capital Gains Withholding Tax shall be 1% of the price at which the security was sold. This is with effect from 1 August 2009.

It is worth noting that, if a specified asset was acquired prior to 1 February 2009, then the rate of CGT in the event that that specified asset is sold will be 5% of the selling price of that specified asset. As such, in the event that an investor, whether they have already invested in Zimbabwe or are contemplating investing in Zimbabwe, desires to purchase or dispose of a specified asset, it is worth noting the existence of this "1 February" proviso, as this proviso would greatly decrease the capital gains tax payable in the event that a specified asset is disposed to or by an investor as part of any investment.

Income Tax

Notwithstanding the taxes discussed above, potential investors in Zimbabwe may also be subject to income tax. All clients, including individuals, companies, partnerships and cooperatives who want to venture into any business venture are required to register with the Zimbabwe Revenue Authority ("**ZIMRA**") and comply with all obligations as stipulated in the legislation.

We are available to provide further and more detailed advice on the different taxes applicable to a new investor whilst also providing advice on the most appropriate manner to make a contemplated investment as tax efficient as reasonably possible.

Managing Country Risk

Aside from the compliance issues mentioned above, country risk factors are some of the key considerations in making foreign investments particularly in developing countries. In the main, country risk assesses the obstacles and dangers of investing in a country, its legal environment and the levels of corruption in that country.[7] It also covers risks linked with doing business in a foreign country, which include sovereign risk, economic risks, exchange control risks, transfer risks and political risk.[8]

The International Country Risk Guide (ICRG) and the Heritage Foundation both generally accepted rankings, rate Zimbabwe as one of the countries with the lowest property rights rankings in sub-Saharan Africa.[9] Zimbabwe's country risk rating is attributed to unpredictability in law and order, the effectiveness of government in the enforcement of property rights and the nationalistic sentiments in Zimbabwe. Given the scepticism over Zimbabwe's property rights investors can have no assurance on their ability to recoup their investment and returns on their investments if they

invest in Zimbabwe. The government is very cognisant of the significance of these criticisms and its announcement and commitment to uphold BIPPA's in January 2013 will go a significant way to addressing these 'investment climate' concerns. We take seriously governments' further announcement that it will shortly revise (for the better), its investment laws and regulations to better accommodate and receive FDI.

Despite these misgivings, Zimbabwe, which is well endowed with resources and has a well-developed infrastructure, has generated interest as one of the top lucrative investment destinations in Africa in the forthcoming years. Investors who are keen on investing in Zimbabwe should not necessary feel discouraged by Zimbabwe's country risk rating but can take comfort in the Bilateral Investment Treaties (BITs) which Zimbabwe has entered into in order to explore investment opportunities and the high returns in Zimbabwe's Tourism, Mining and Agriculture sectors. In modern times, foreign investors wishing to invest in developing countries are often aided and protected by Bilateral Investment Treaties (BITs). BITs are reciprocal agreements signed between countries in order to promote and protect investments in the contracting States. Zimbabwe has entered into a series of forms of BITs known as Bilateral Investment Promotion and Protection Agreements (BIPPA). As of late, Zimbabwe has ratified agreements entered into with Denmark, China, South Africa, Netherlands and Switzerland.

Nearly all BIT Agreements entered into by Zimbabwe contain standard clauses which provide a legal basis for foreign

investors to enforce their property rights in Zimbabwe. These include clauses which guarantee the non-discrimination of foreign investments and also provisions which oblige the host government to take legislative measures and/or any other necessary measures within its power to protect investments of foreign investors from contracting States.

More important is the fact that some BITs entered into by Zimbabwe contain provisions which deal with expropriation of property. Expropriation clauses found in most BITs are of particular importance to foreign investors in Zimbabwe given the extensive expropriation of property in Zimbabwe by the Government during the land reform programme. The general position in most BITs is that, foreign investors whose property has been expropriated must be given prompt, adequate and effective compensation. In addition, expropriation of property must be in the interest of the public and must take place after due process. It would be prudent for an investor interested in investing in Zimbabwe to seek clarity as to whether the governing BIT provides for the above mentioned requirements in the event of expropriation.

BITs usually have standard clauses which provide for the ease of transfer of funds into and out of a contracting State. They also make provision for recourse to international arbitration tribunals to settle claims arising from unfair treatment of their property. The fact that the disputes can be brought before international fora encourages investors who can be sceptical about the independence, competence, fairness and neutrality of the domestic courts in the host country.

Foreign investors need to therefore take a holistic view when exploring investments in Zimbabwe based on its country risk rating. Citizens of countries which have ratified BITs with Zimbabwe can rely on the clear enforceable rules contained therein, which protect investors and reduce the risks associated with investing in Zimbabwe. Nationals of non-contracting states can also benefit from the protection of BIT Agreements in Zimbabwe, through the creation of offshore structures in contracting countries, as a conduit to Zimbabwe.

Other Positive Developments

The Government has embarked on initiatives to create a conducive investment climate in Zimbabwe. Zimbabwe is a signatory to the Multilateral Investment Guarantee Agency, the Overseas Private Investment Co-operation, the International Convention of the Settlement of Investment Dispute and the United Nations Commission of International Trade and Arbitration Law.[10] These treaties also help secure foreign investments and also avail alternative dispute settlement mechanisms for foreign investors in Zimbabwe. Significant progress has also been made in Zimbabwe which can be of interest to foreign investors. Such progress includes the fact that the Reserve Back of Zimbabwe has of late made it mandatory for banks to comply with Basel II capitalisation requirements in order minimise financial and regulatory risks associated with operating a Bank. Basel II provides for risk and capital management requirements that seek to ensure that banks hold capital reserves which are appropriate to their operational risks. The implementation of Basel II will go a long way in improving investor confidence in Zimbabwean Banks. Compliance with international standards ensures that investors have effective and secure structures that enable the ease of transfer of the funds in and out of Zimbabwe.

Foreign Investors can venture into business through merging and acquiring Zimbabwean enterprises and also by exploring investments through capital markets. The Zimbabwean stock exchange is one the oldest and largest in Africa and efforts have been made by the Zimbabwean Government to establish a Securities commission to regulate the trade of securities and also to ensure that the capital and securities market functions in a secure and orderly manner.

Conclusion

These initiatives and institutions in place signal to the world that Zimbabwe is indeed ready for business and is a viable hub for doing business within the SADC region. We highly recommend that a structured approach be the driving basis of investing in Zimbabwe.

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1 See "Zimbabwe ranks top three African Investment destination" at http /harare24.com/index-id-Business-zk-13066.html (Last accessed 1 January 2013)

2 Eugene Majuru "Mashakada rebranding Zimbabwe in London" Available at http://www.zimdiaspora.com/index.php?option=com_content&view=article&id=10152:mashakada-attends-zimbabwe-investment-conference-in-london&catid=38:travel tips&Itemid=1(Last Accessed on 7 January 2013

3 See "Foreign Exchange Guidelines" published by Reserve Bank of Zimbabwe at http://www.rbz.co.zw/pdfs/2009%20Julymps/foreignexchange.pdf.

4 Income Tax Act [Chapter 23: 06]

5 Section 93 applies whether the person is inside or outside Zimbabwe.

6 Section 6 of the Capitals Gains Tax Act [Chapter 23: 01]

7 See "definition of country risk" at http://www.investopedia.com/terms/c/countryrisk.asp#axzz2He6OhIrl(Last Accessed on the 31st of December 2012

8 *Ibid*

9 'Newsday' "Zim one of least free economies" Available at http://www.newsday.co.zw/2013/01/11/zim-one-of-least-free-economies/

10 See "Minister Elton Mangoma discusses Investment opportunities in Zimbabwe" Available at http://www.zimbabweprimeminister.org/index.php?option=com_content&view=article&id=107:minister-mangoma-to-address-investment-and-economic-recovery-workshop-in-pretoria&catid=43:economic-planning-and-development&Itemid=95 (Last Accessed 7 January 2012)

Where opportunities exist, risks follow

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Given the changing global investment landscape, it is not necessarily unsurprising that private equity interest in sub-Saharan Africa has doubled since 2007.

However, before one gets carried away with superlatives about this growth, it should be noted that private equity fundraising in Africa, averaging about $2bn annually in 2010/2011, is still in its infancy. Additionally, recent global investment conditions have impacted on Africa: Sub-Saharan M&A activity was down by 23% in the first 9 months of 2012, and despite the best efforts of regional heavyweights such as Kenya, Ghana and Nigeria, much of the activity remains within South Africa – itself a country facing significant political challenges in the wake of the union clashes earlier this year in its mining sector. The North African powerhouse, Egypt, which itself has historically monopolised regional M&A league tables, is also facing significant socio-political challenges.

While emerging market specialists such as Actis, Helios and ECP have closed large new Africa funds within the last couple of years, it is notable that major global players are also starting to look seriously at opportunities on the continent; Carlyle's new African fund launched earlier this year recently made its first deal (in a Tanzanian agricultural firm), while fellow PE heavyweight KKR has reinforced its focus on the African market by recently headhunting a partner from Helios. Other emerging market investors are looking seriously at the continent too, with Brazil's BTG Pactual hoping to raise $1bn for an Africa fund.

The drivers for a lot of this optimism in the continent are multiple. Africa has seen some of the highest growth rates of any global region over the last 10 years, and this growth is forecast to continue; the regional GDP growth rate is expected to hit 4.8% in 2013 - well above the global average. The most important factor is the continent's rapidly-expanding middle class – IMF figures estimate that while there are currently 60 million households with incomes of $3,000, this number will have expanded to 100 million by 2015. But with all of this excitement and interest in the continent, risks abound. Corruption, for example, remains an important concern for many investors, with 19 of the top 20 performing African economies ranking less than five out of 10 on Transparency International's Corruption Perceptions Index. Similarly, nine of the bottom ten countries on the World Bank's Ease of Doing Business Index are in the sub-Saharan region.

In seeking to mitigate risks, there are a number of particular considerations and steps that investors should consider when deciding on new private equity opportunities:

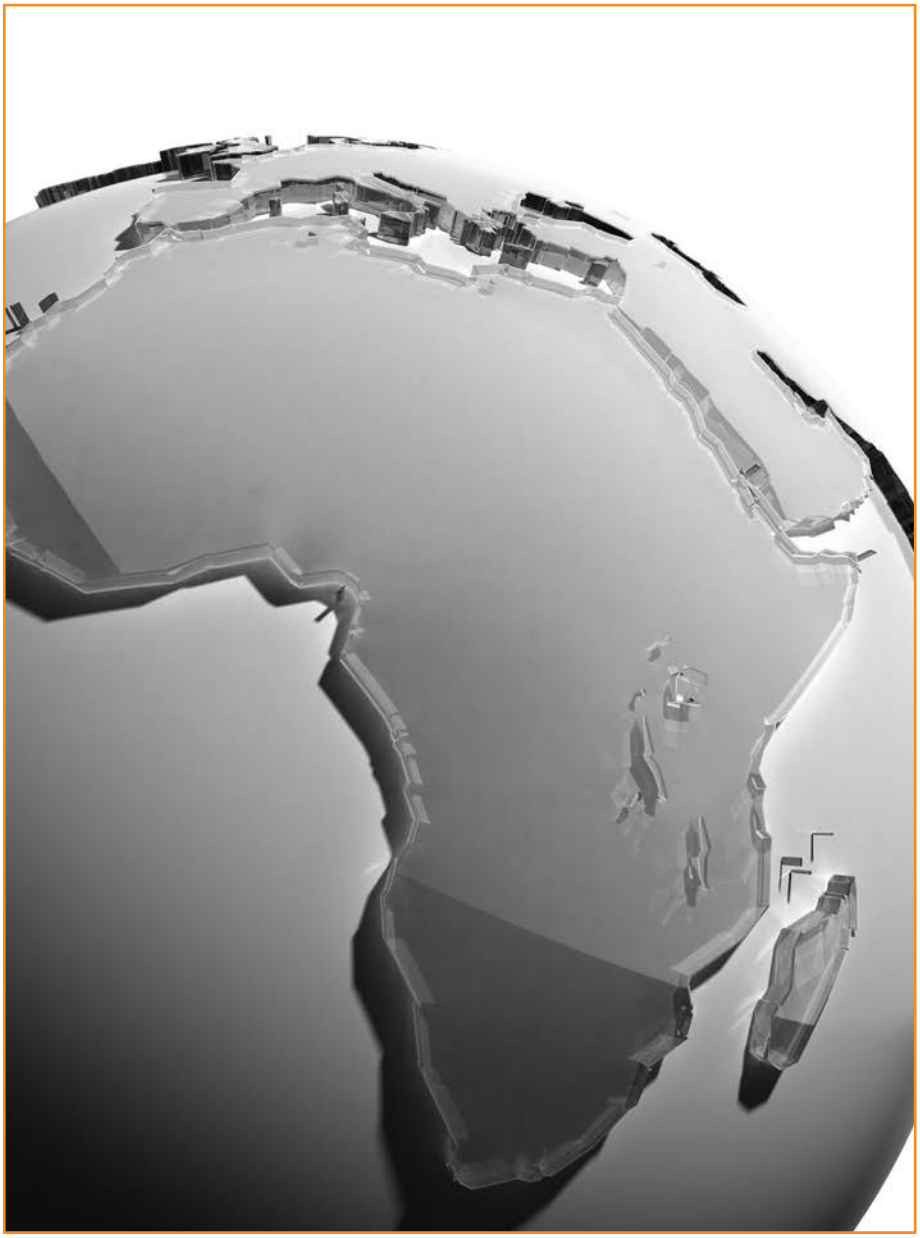
Pre-transactional business intelligence

Pre-transactional business intelligence early in the investment process can enable fund managers to gain competitive advantage through identifying suitable private equity targets from a number of potential options. This is particularly important in Africa, where poor public filings and an absence of other available documentation can complicate the process of selecting a target and defining the investment. A recent private equity client had just this problem: after engaging in a mining opportunity in southern Africa without conducting the necessary early checks, the fund's subsequent due diligence discovered major reputational red flags associated with its partners that forced it to unravel months of negotiations, resulting in both financial losses and impacting its local reputation.

Due diligence

Most funds are obliged to conduct some level of due diligence into their investment targets as part of their regulatory compliance procedures. However, in Africa, the need for integrity due diligence to understand the local reputation and track record of the target, as well as to gain clarity on any undisclosed interests or ownerships, is vital as the local investment market can often be opaque and multifaceted. The growing rise of international anti-bribery regulations such as the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act (UKBA) make the need to comprehensively understand the background and modus operandi of local partners and investment opportunities all the more important. These laws dictate that the level of due diligence should be proportionate to the risks, and as such due diligence should be tailored to the market the investor is active in. So, light public record-only checks that might be suitable for looking at targets in more developed markets may well not be satisfactory when conducting an investment in West Africa.

Due diligence should also be viewed as a process, not a one-shot action. Frequently investors conduct due diligence at the start of the investment, then never again. However, over time, the dynamics of the investment will change, new partners will come on board, and market factors will shift, and all too often a failure to monitor these changes can result in significant problems. A major agribusiness with subsidiaries in East Africa earlier this year caused problems for its private equity investors when it was discovered that the local subsidiary was involved in corrupt



business practices. It was subsequently established that these practices had evolved over time so were not picked up through the initial due diligence checks. However, a failure by the fund to adequately monitor its investment resulted in financial, reputational, as well as potentially regulatory, concerns.

Legal, regulatory and political risk

Africa presents investors with a diverse and complex operating environment, and fund managers keen to unlock to various investment opportunities need to ensure a thorough understanding of the various legal, regulatory and political risks associated with their potential investment. This assessment may include considering the integrity of the local legal systems to ensure that any intended contracts or financing programmes are workable and enforceable. Black economic empowerment laws and their derivatives are becoming increasingly common across the continent, and thus a full understanding of local ownership laws is imperative. As a warning, investors need look no further than to Zimbabwe's recent controversial efforts to enforce its new indigenisation laws in the extractive industries sector. While the laws currently look for indigenous firms to control 51% of local joint ventures with international firms, in a nod to the upcoming 2013 presidential election, President Mugabe back in December told his party he was considering full nationalization, with local firms holding up to 100%.

In addition to understanding local legal and regulatory systems, developing a deeper understanding of the local political system and of local political and economic policy, such as a government's efforts to reform the investment laws, is important. The Mozambican President, speaking on a recent visit to London, stated that the country is keen to relax its investment process to facilitate inward investment. However, in the same breath he stressed that any investor must make a "substantial contribution to the country's development". What exactly this will mean for investors remains far from certain. Elsewhere, even in supposedly-stable countries such as Zambia, issues such as tight control over foreign currency transactions and minimum wage legislation are concerning foreign investors, illustrating the need for vigilance.

Focusing on the upside

Interest in African private equity is likely to grow over the coming years, a reflection of the growing optimism and enthusiasm investors have for the continent. With these new opportunities will come inevitable new risks. However, if managed correctly, these risks need not necessarily be insurmountable. Ensuring that suitable considerations have been given to concerns ahead of time, and that prominent issues and potential problems have been identified and mitigated, are all essential steps for fund managers to take full advantage of the various opportunities the continent is capable of providing.

Example Transactions in Africa

ADC African Development Corporation

on the consortium arrangements and investment into Union Bank of Nigeria plc (one of the two largest banks in Nigeria) involving a US$500 million consortium equity investment and up to US$250 million of Tier II securities

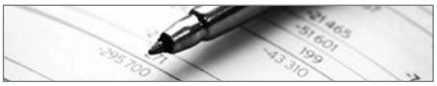
Helios Investment Partners

on the US$145 million acquisition of South Africa's INM Outdoors Limited, the leading outdoor advertising business in Africa with operations in 13 African countries as well as on the groundbreaking US$170 million acquisition of a 24.99% stake in listed bank, Equity Bank Limited of Kenya

AfricInvest Capital Partners

on KES 918 million investment in Family Bank Limited of Kenya, the second largest microfinance bank in Kenya by funds managed by ACP, FMO and Norfund as well as on a €9 million investment in a Libyan soft drink and bottled water business

The sellers of Aureos Capital



on the sale to Abraaj Capital to form a combined global private equity fund management group with approximately US$7.5 billion under management

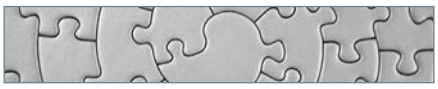
AFREN plc

the main market listed African oil exploration company on its farm-in to an exploration block off the Western Cape of South Africa

Africa Opportunity Fund

on its its AIM listing and US$125 million fundraising for strategic and opportunistic investments in Africa

Development Partners International



on their deal flow in a number of jurisdictions in both Anglophone and Francophone Africa

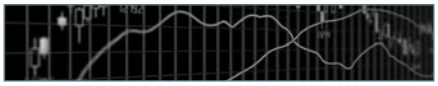
Och-Ziff Capital

on its equity/debt investments and subsequent exit in a joint venture relating to an oil and gas exploration and production company and on its 13.1% equity investment in Ophir Energy plc, the pan-African oil and gas exploration company.

Standard Chartered Bank

on a syndicated facility for Zambian mining companies, Bwana Mkubwa Mining Limited, refinancing US$30 million and Konkola Copper Mines plc, refinancing US$35 million

Masawara Plc



on its admission to AIM and placing to raise US$25 million seeded with interests in 30% of a listed Zimbabwean company and a 40% interest in The Joina Centre retail mall as well as on a proposed transaction to acquire the downstream assets of Shell and BP in Zimbabwe

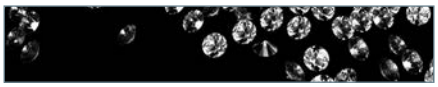
Aureos Capital

on the global emerging markets fund manager's US$380 million Africa Fund which closed in 2010 as well as on its US$100 million African healthcare fund cornerstoned by leading DFIs and a world renowned Foundation

Government of Lagos State

on contracts and construction and development of rail track and infrastructure awarded to a Chinese contractor for a US$1.2 billion light rail mass transit system known as the Blue Line and on a separate PPP agreement

Och-Ziff and Goldman Sachs



on a US$45 million pre-IPO fundraising to Namakwa Diamonds plc and its subsequent admission to the main market of the London Stock Exchange raising £90.71 million to fund colluvial diamond mining operations in Namibia and the Democratic Republic of Congo

Satya Capital

on its co-investment in Tanzanian FMCG business, Chemi & Cotex Industries Limited

Aman Bank for Commerce and Investment

on the proposed sale of a 40% stake to the Portuguese listed bank, Banco Espirito Santo (BES)

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