

Entering High-Risk Jurisdictions: Key Considerations for Investors

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As part of our series on investing in high-risk jurisdictions, we discuss key strategies that investors should consider when entering regions impacted by conflict or political instability to help businesses navigate these perilous environments while protecting their people, assets and reputation.

Markets in such high-risk jurisdictions present compelling untapped opportunities for investors. However, as we discuss below, any investment should be accompanied by thorough due diligence, risk management strategies, legal protections and contingency planning to mitigate risks.

Comprehensive Risk Assessment

Before entering any high-risk jurisdiction, it is important to conduct a thorough risk assessment. This should include:

- **Understanding the political environment:** investors should understand the strength of the governmental and judicial institutions, the dynamics of the current ruling party, any coalition government tensions, frequency of government changes and their relationship with other political factions.
- **Third party risk assessments:** a third-party risk assessment is critical including testing the target's supply chain risk management strategy for security risks.
- **Understanding counterparties and partners:** it is essential to diligence and understand the background of your counterparties or joint venture partners, for example:
 - are they a government entity or other public body and are they likely to have sovereign immunity? If not a government body, do they have any political affiliations or other political ties?
 - what is the degree of influence that they wield in that country?
 - is it a family, and if so, what are the family dynamics and tensions that could impact the investment?
 - what is the counterparty's (and key individuals) market reputation as a local partner? Is there any history of disputes

with other investors? Is there any history of allegations of bribery, or other non-compliances or unethical business practices?

- **Understanding the local dynamics:** a nuanced understanding of the local dynamics will enable investors to sufficiently appreciate the risks they are taking on and the sensitivities to be mindful of. Engaging meaningfully with affected stakeholders, including local authorities, displaced communities and regional experts, will facilitate this and allow for a more holistic understanding of the risks, for example, is there a particular conflict, is corruption endemic, or is judicial recourse not well embedded and subject to uncertainty?

Due Diligence & Structuring

Economic, legal and geopolitical factors along with local dynamics can create a complex web of regulation and enforcement, where transactional and operational risks need to be understood and managed. It is important to identify and mitigate those risks by thinking ahead and comprehensive due diligence is a critical component of the process.

- **Structure & perimeter:** consider the optimal structure by which to implement the acquisition such as an asset or share acquisition or court approved processes, and assess if there are any local law nuances, for example, around the transfer of liabilities. It will be important to diligence the transaction perimeter and identify key value leakage areas. Share ownership disputes are not unusual and to address that, a thorough investigation is required alongside robust contractual protections such as escrow arrangements. It is also not uncommon for there to be government

or local authority pre-emption rights or requirements of no-objection certificates.

- **Bribery & Corruption:** heightened attention to regulatory compliance, particularly anti-money laundering and counter-terrorism financing requirements is required. Enhanced due diligence measures should be routinely undertaken, including additional checks on key counterparties or joint venture partners such as verifying the sources of wealth and funds and the screening of sanctions lists, global watchlists and 'Politically Exposed Persons' lists.
- **Legal & regulatory framework:** it is important to understand the regulatory framework and its implications on the investment on an ongoing basis, for example, are there exchange control regulations and restrictions on moving cash in and out of the country? Are there any dividend blocks? Are there export bans or other discretionary license requirements? Consider whether any proceeds generated by the target company ought to be ring-fenced. What are the data privacy requirements and are there requirements for local servers and localization of data?
- **Exit:** such jurisdictions are unpredictable and therefore, investors need effective exit strategies from day one. Consider whether any government or third-party approvals are likely to be needed on an exit or for break fees, and if yes, consider seeking such approvals upfront or ways to mitigate the risk that these approvals can be leveraged to political ends at a later date.

- **Tax:** tax considerations are key when structuring investments particularly around withholding and exit taxes and permanent establishment risks. Seeking to anticipate evolving tax risks is valuable, for example, investors should consider whether the historic behaviour of local tax authorities may be indicative of potential risks such as possible retrospective taxes, and how the application of any tax treaties would operate. We have historically seen allegations of non-payment of (new or evolving) taxes used as a means of justifying expropriation of assets on exits – care needs to be taken on transaction structuring to mitigate this risk.
- **Local protection issues:** assess whether there are mandatory dispute resolution processes or local laws that local courts could forcibly apply to foreign-law governed contracts. International arbitration is commonly used as an alternative to using the local court system for dispute resolution, and there are particular watch-outs to making sure this applies effectively. Note also that local governments can require local law to govern contracts (especially where a government body is a counterparty), in which case it is important to test the interpretation of drafting and concepts included versus more internationally accepted standards of business law.
- **Intragroup services:** as part of the diligence process, map the scope of anticipated intra-group services to support the target's business model and facilitate synergies – it is important to think ahead to anticipated reliance in both directions and how that could impact wider group operations, for example, if cut off with minimal notice, or where a party could be forced by a government to maintain group level services into a local target following exit.
- **Employees:** consider how best to structure employee presence on the ground and appropriate incentivization arrangements e.g. to try and neutralize any local corruption concerns. Will a proportion of the employees be expatriates from other jurisdictions? Plan security arrangements as part of setting up the investment and have an evacuation plan, if needed.
- **Investment treaties:** before entry into a new region, investors should assess the availability and applicability of bilateral investment treaties, which could provide important protection against breach by the state of investment obligations or undertakings. Please see our upcoming blog post on using bilateral investment treaties to manage risk in high-risk jurisdictions for a deep dive into this area.

Acquisitions & Investments – key considerations

A combination of state, transaction and operational risks can make for an unpredictable investment environment, and it is valuable to have strong contractual protections in the acquisition and joint venture agreements:

- **Termination rights:** negotiate robust contractual protections such as no 'material adverse change' and force majeure provisions, which appropriately cover local law requirements (including material changes in law), extrajudicial

risks such as sanctions and local civil unrest or other local risks.

- **Conditions:** include government and third-party approvals as conditions to the investment, and importantly, identify the relevant political and local stakeholders where consents are likely to be required. Where feasible, investors should engage with such stakeholders and understand their views. We have seen that local regulatory change of control consents can often be prone to political interference – be aware of this risk early; mapping decision makers using local expert knowledge can help reduce these uncertainties.
- **Break fees:** consider having a walk-right or break fee in the event the investment is adversely affected, appropriate approvals are not received or there is undue government interference. For example, what if the government decides to no longer support the project? Consider the impact that could have on the investment and appropriately reflect it in the transaction documents.
- **Warranties & indemnities:** warranty protection particularly around compliance and anti-bribery and corruption is important alongside robust recourse measures such as escrow arrangements or third-party insurance.

Joint Ventures & Collaborations – key considerations

There are certain additional considerations in cases of collaborations:

- **Local laws:** understand what restrictions would apply to increasing the investor's stake in the local

company and if, for example, there are local ownership rules that prevent majority ownership by a foreign party.

- **Policies:** map the target's existing policies against relevant laws and the investor's requirements and test if they are sufficient or need to be amended to reflect additional strengthening measures followed by robust systems to carefully monitor ongoing compliance.
- **Intellectual Property:** have appropriate operational measures to protect IP and prevent IP leakage, for example, to have restrictions and requirements for local use of any existing data of the investors or their brands. Consider whether to set up a separate local brand which is easier to separate or divest from a global brand in case of future reputational issues.
- **Step in rights:** where there is a material breach of policies or IP rights, it is valuable to have step in rights for the investor to effectively 'step in' and remedy the situation.
- **Exit:** consider the exit strategy in different scenarios, for example, in cases of material breach by the target or the counterparty or situations relating to sanctions or political instability. Consider whether put and call options are appropriate, the relevant pricing in such circumstances and whether there are any exchange control or other regulatory constraints on pricing.
- **Reserved matters:** this is an important protective measure especially in areas such as anti-bribery and anti-money laundering compliance, supply chain matters and IP debates.

Political Risk Insurance

- Political risk insurance is a critical tool for protecting investments in high-risk jurisdictions. Unlike standard commercial insurance, political risk insurance addresses risks that conventional policies do not typically cover. It is designed to manage risks arising from the adverse actions, or inactions, of governments and is typically a bespoke product that is tailored for risks relevant to the specific asset or investment. Generally, political risk insurance can be used to cover risks including political violence, confiscation, nationalization, expropriation, contract frustration, forced abandonment and divestiture and license cancellation.

Conclusion

Investing in high-risk jurisdictions demands a strategic balance between opportunity and caution. Success hinges on the ability to skillfully navigate the uncertainties and risks that are inherent in such jurisdictions. By proactively mapping and managing risks, investors can not only safeguard their investments but also contribute meaningfully to economic development in regions where responsible investment is most needed.