**<u>How to Assess and Mitigate the Risks Associated with<br>Overseas Projects in Developing Countries</u>**

**by Mark Garfinkel, Esq.**

Your company has just been asked to consider a joint venture investment in a Sub-Sahara Africa project. Maybe your company has done business overseas before, but this is quite different. You are now considering a joint venture with a local group with ties to high level foreign officials. Your company has been asked to make a sizable investment in a large complex overseas project. You have been given copy of a foreign license that was just issued to your potential foreign partners and asked to assess the risks the company will face if it goes forward with the project. There is no business plan.

Where do you begin? At the outset, it is imperative that you understand that the risks are serious, many and varied. Some risks are general, some are country specific or regional and others are related to the type of project or industry sector. Failure to A small mistake could be financially devastating for your company. For example, if you fail to accurately assess the risks posed by anticorruption laws such as the FCPA, the result could be a resource draining bribery investigation. It is not enough to just identify the risks involved in doing a particular project overseas. Once you assess the risks, you should take steps to find alternate ways to mitigate those risks.

Developing a detailed checklist for evaluating an overseas project is essential. Following are the most important general areas that should be considered when developing a checklist for a potential project risk assessment:

1. Background Checks: These are imperative and should be done on every foreign principal, entity and involved third party such as agents and contractors. It is very important that background checks be done early as possible before relationships develop, and this requires a gathering of specific identifying information. Asking a potential foreign partner for his passport number after you have been breaking bread together for months is a surefire way to sour a business relationship. You should do what is known as a Level 2 background check on all equity holders, officers and directors, as well as on the companies involved in the deal. A Level 2 search is the most common type of search used for compliance with know-your-customer (KYC) requirements and the FCPA by private equity funds and investment banks. The cost is about $2000 per search. Watch out for red flags such as relationships with government officials and individuals ties to un-savory individuals. Know which foreign government officials stand to profit from the success of your project and where they have relationships with principals in the deal. The checks must be extensive and include local and English media, and on-the-ground checks of in-country data bases not connected to the internet. More in-depth feet on the ground searches can be done in rare cases if necessary at a much higher cost.

2. Deal Structure: Potential project deal structure needs to be carefully evaluated to address any potential currency conversion, taxation and ownership issues as well as taking currency out of the country. Deal structure can mitigate risk in many ways and maximize tax savings. It must

be carefully considered at the front end and there will always be options although they may be limited by country laws. Take steps to protect your investment with proper deal-structure.

3. Political Risk Insurance (PRI): In most developing countries, you will need to consider PRI. This insurance will cover expropriation, political violence, terrorism and other issues such as currency conversion. Depending on the industry sector that the potential project is in, PRI will probably be essential and is often required by lenders. The two best sources to shop are the Overseas Private Investment Corporation (OPIC) and the World Bank's MIGA. Applications need to be prepared, pricing and terms need to be negotiated and the contract carefully reviewed to make sure the coverage is effective. Note that successful arbitration against a host government is often required before payment on a claim will be made by the insurer.

4. General Country Risk Assessment: There are many sources of relevant information. Certainty any risk assessment report would address all of the country factors looked at by the World Bank, the MCC, Transparency International and other entities that support emerging market investments. Calls should be made to various developmental agencies and banks, the Department of State and Commerce, private equity funds, and other such sources to get a good read on current investment related disputes in the country and region. The goal is to end up with both a general overview of the business environment, but also an insider's view of some of the problems that investors are currently facing in the country and region. This information will help you identify both general and project specific risks and may lead you to consider deal structure changes.

5. Environmental and Governance Issues: Both environmental issues and corporate governance issues need to addressed, especially on infrastructure projects that are more likely to affect local communities. Environmental audits might be necessary and groundwork may need to be laid with NGOs to insulate the project from criticism at a later stage. In general, it is wise for any company investing overseas in the developing world to consider taking steps to work closely with, and help, the local community.

6. General Due Diligence and Compliance Issues: In addition to doing background checks on your potential partners and general due diligence on the financial viability of the project, it is very important that the project company and its partners have a good handle on all of the compliance issues that might affect the project. For example, you will need to put in place the FCPA/anti-corruption protocols and policies needed to demonstrate to regulatory authorities that proper precautions were taken. Training in this area will need to be done and certifications obtained from partners and other parties involved in the project. Established companies already operating in the emerging markets generally have these safeguards in place but new companies need to adopt them. Corruption is always going to be a big concern. In addition to the FCPA, there are generally other compliance issues to consider such as embargos and export controls.

7. Consider Obtaining Funding/Support from US developmental agencies: Money for overseas projects overseas is generally available for "developmental" overseas projects from US agencies such as EXIM and OPIC. While the application process may take some time, there is a great advantage to obtaining support, funding or PRI from a US agency or another international

financial institution. Such a lender will be invaluable as a powerful source of advocacy if investment disputes develop, especially where foreign government entities are involved.

8. Central Banking Issues and Currency Conversion: It is key to have an in-depth understanding of central bank regulations as well as local law and regulations relating to the project. Currency conversion issues must be considered, and you should become familiar with regulations on taking currency out of the country.

9. Licenses and other Documents obtained from Government Entities: Sufficient due diligence needs to be done to insure that there are no wrinkles and that all licenses and other approvals are properly in place and authentic. Make sure you know the history of any disputes involving licenses in the host country. Beware of the unexpected, I have seen many instances of licenses and contracts being pulled or renegotiated when the ruling party changes or another local group complains about the circumstance under which the license was granted.

10. Local Counsel: Good local counsel is essential. They can be most helpful during the due diligence phase and will advise you on regulations affecting your project.

11. Local Partners: While local partners can be instrumental in leveling the playing field and keeping an eye on operations they can also be a great source of problems and liability. Needless to say many deals get into trouble when local partners are not carefully selected. The background search effort is key here. Always assume your company will need a boots-on-the-ground presence.

12. Security: For obvious reasons this has become more of an issue in some regions of the world.

This is not meant to be a comprehensive list of all of the general risk-related areas you should consider. It may or may not be necessary to conduct a detailed formal country and project risk assessment. The level of detail in regard to any project risk assessment will depend on the sophistication of your senior managers. It will also depend on where you are obtaining project funding and the degree to which you need to educate and/or blue sky folks who have never worked in the region. Of course, any business plan or private placement memorandum on the potential project will require a more formal and in-depth consideration of project risks and their mitigation.